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Politics this week

May 20th 2004
From The Economist print edition

Who will rule next?

Reuters

Izzedin Salim (or Abdul Zahra Othman, his original name), a Shia holding the rotating presidency of **Iraq's** American-appointed Governing Council, was killed (with nine others) by a suicide car-bomber outside the ruling coalition's headquarters. President George Bush and Britain's prime minister, Tony Blair, said that the killing would not derail the plan for a formal handover of power at the end of June.

See article

America denied reports that its aircraft had killed more than 40 people at a **wedding party** in Iraq. The target, said a military spokesman, was a “safe house” used by foreign fighters.

Army Specialist Jeremy Sivits became the first American guard accused of abusing Iraqi detainees to go on **trial in Baghdad**. He pleaded guilty and was sentenced to a year in jail. Human-rights groups complained that the American authorities had refused to let them attend. New pictures were aired on American television, showing American soldiers grinning over the corpse of an Iraqi who died in custody at Abu Ghraib jail.

See article

The UN Security Council condemned **Israel** for invading Rafah, a town and refugee camp on the Gaza strip's southern border with Egypt, killing at least 39 Palestinians, more than half of them civilians, demolishing more than 100 houses and leaving some 1,000 Palestinians homeless. Israel said it was seeking arms-smuggling tunnels. The raid followed fighting last week in which 13 Israeli soldiers and 30 Palestinians died.

See article

Marwan Barghouti, a **Palestinian** sometimes tipped as a successor to Yasser Arafat, was found guilty of terrorism by an Israeli court.

Kuwait's cabinet approved a draft law to allow women the vote and to stand for parliament, which must now endorse the proposal.

Zimbabwe's president, Robert Mugabe, told a Kenyan newspaper that he would retire in four years. Mr Mugabe, who turned 80 this year, has ruled Zimbabwe since 1980.

See article

After clashes between Christians and Muslims that have left hundreds dead in the past month, **Nigeria's** president, Olusegun Obasanjo, declared a state of emergency in one of the worst-hit states in the country.

See article

Surprise election

The Congress party won an unexpected victory in **India's** general election. Sonia Gandhi, its leader, caused another shock by refusing to become prime minister. Manmohan Singh, a former finance minister and a reformist, was chosen by Congress instead. India's financial markets fell sharply at first but later recovered. The Communists said they would support the new government.

See article

One year after launching a military offensive designed to crush separatist rebels in the province of Aceh, **Indonesia's** government lifted martial law there.

Constitutional talks began in **Myanmar**, under the close scrutiny of the ruling military junta. The main pro-democracy party is boycotting the discussions. Its leader, Aung San Suu Kyi, is still under house arrest.

See article

China and **Kazakhstan** signed an agreement to build part of a pipeline that will transport oil from the Caspian Sea to China's western border.

Taiwan's president, Chen Shui-bian, was inaugurated for another term after presidential elections in March. The opposition, which lost by a narrow margin, has demanded a recount, which is under way.

See article

No prime minister

The presidential nominee to be **Poland's** prime minister, Marek Belka, failed to win a confidence vote in parliament. The parliament will now search for its own candidate, but it seems unlikely to agree on one. Mr Belka may get the job after all.

European Union foreign ministers resumed negotiations on the draft **EU constitution**, which stalled last December. The talks started badly, denting hopes of a deal by next month's EU summit.

See article

The European Commission ended its five-year moratorium on **genetically modified foods**, agreeing to permit the import of a GM strain of maize.

See article

The European Commission praised **Turkey** for its progress towards fulfilling the criteria needed to begin membership talks with the EU. Britain's Tony Blair, on a visit to Turkey, gave similar encouragement to its prime minister, Recep Tayyip Erdogan. The Turks want the EU to say by December when talks will begin.

State of same-sex matrimony

AP

Massachusetts became the first American state to perform legal same-sex marriages. Thousands of supporters turned out to celebrate the first nuptials. Opponents around the country vowed that they would eventually nullify the law through ballots and constitutional amendments.

See article

The **Bush-Cheney campaign** reached its goal of raising $200m—double the amount it raised in 2000. Meanwhile, the Federal Election Commission said that "527" independent political groups, which are usually of a leftish disposition, could continue to raise and spend "soft money" on television ads and grass-roots organisation.

Rudy Giuliani and Michael Bloomberg, the former and current mayors of New York, testified before the **September 11th Commission**. Meanwhile, a witness spoke of the confusion in the World Trade Centre's south tower, the first to collapse, after announcements urged people to return to their desks.

No escape

AFP

A fire in a severely overcrowded prison in **Honduras** killed 103 inmates. All of the victims were members of youth gangs. Honduras's government launched a crackdown on such gangs last year.

See article

America started talks on a **free-trade agreement** with Colombia, Peru and Ecuador.

Leonel Fernández, a former president and free-marketeer, regained the presidency of the **Dominican Republic**, having won about 56% of the vote. The incumbent, Hipólito Mejía, won 34%.

Brazil's government rescinded an expulsion order against a *New York Times* correspondent who had published a story claiming that President Luiz Inácio Lula da Silva had a drink problem.

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Business this week

May 20th 2004
From The Economist print edition

Troubled waters

Oil prices continued to rise, surpassing $41 a barrel, as raging demand showed no sign of abating and the situation in the Middle East worsened. OPEC members appeared divided over whether to increase production quotas; sceptics asked whether the oil cartel had enough spare capacity to make much of a difference.

See article

Champions league

France and Germany backed proposals for an industrial policy that will help European companies to become "**champions**", despite a poor record of state intervention over the past decades. Opposition by more market-minded countries and the EU's own competition rules may help to limit the damage.

See article

However, the EU was set to approve a French government bail-out of **Alstom**. The ailing engineering group's shares briefly surged on the news that approval for a *euro*3.2 billion ($3.9 billion) rescue package was coming. Germany's Siemens muttered about legal action to block the deal. It had hoped to benefit from a break up of Alstom.

See article

ThyssenKrupp hastened the pace of consolidation in Europe's naval-defence industry by agreeing a merger between its shipbuilding arm and HDW, the world's leading maker of non-nuclear submarines. The German industrial conglomerate will pay *euro*240m ($289m) for 75% of HDW.

Phoney accounts?

Lucent Technologies was fined $25m by America's Securities and Exchange Commission for failing to co-operate with an investigation into the alleged inflation of revenues by over $1 billion at the end of the dotcom boom.

Nortel Network's shares plunged after a leading pension fund launched a class-action lawsuit against the embattled Canadian telecoms-equipment firm alleging that it paid huge bonuses based on "falsely positive" results in 2003.

Hewlett-Packard's profits in the latest quarter jumped by 34% compared with a year ago, to $884m. The giant computer firm said that corporate IT spending was recovering slowly.

Salesforce.com delayed its initial public offering for a second time after its boss, Marc Benioff, gave an interview to a newspaper in violation of the "quiet" period that limits communication by company executives before public share issues.

Sony's disposition

Sony confirmed that it was in exclusive takeover talks with **Metro-Goldwyn-Mayer**, Hollywood's last big independent film studio. The Japanese entertainment giant may pay up to $5 billion to get its hands on MGM's back catalogue and reinforce its strategy of providing a complete package of hardware and content.

British Airways' cost-cutting efforts seem to be paying off. The airline said that profits for the year to March had nearly doubled compared with the year before, to £130m ($220m), despite a decline in revenues. But BA gave warning that rising fuel prices would hurt it and other airlines.

Air Canada failed to reach agreements with one of its unions over cost-cutting measures. The insolvent airline could face liquidation if it fails to reach a compromise and so secure fresh financing.

The Bush administration announced rules to speed the approval of new formulations of **anti-HIV drugs**—essential for fighting AIDS in the developing world. AIDS activists complained that this was another hurdle to block cheaper generic drugs from reaching the world's poor through America's $15-billion AIDS package.

See article

Sir Clive Thompson was ousted as chairman of **Rentokil Initial** in a boardroom coup at the ailing British business-services firm. Sir Clive was widely credited with masterminding the company's bumper growth in the 1980s and 1990s but was told that his dominating influence was now holding the company back.

After years of wrangling, **Switzerland** finally agreed to levy a withholding tax on the savings accounts of EU citizens as part of a series of bilateral agreements that also includes deals on trade and the environment. Switzerland was rewarded with entry into the EU's passport-free area, probably in 2007.

See article

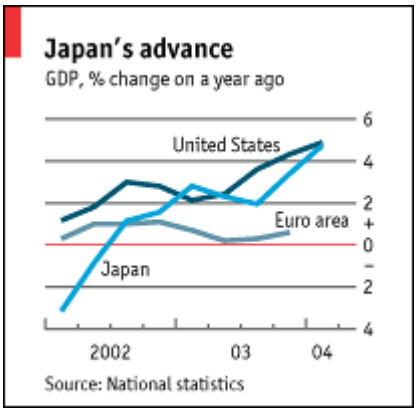
A new term

George Bush officially nominated **Alan Greenspan** to serve another four years as head of the Federal Reserve. Mr Greenspan's fifth term will see him celebrate his 82nd birthday in the job.

See article

Japan's economy sustained its bumper rate of growth, expanding by 4.7% in the year to the end of the first quarter. Rising consumer spending, exports and investment all helped.

See article



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India's election

Who, me?

May 20th 2004
From The Economist print edition

A sequence of unexpected events has given India its most reformist prime minister ever

Get article background

AFP

SINCE nobody, and certainly not Sonia Gandhi herself, imagined the Congress party would win India's election, it is hardly surprising that the past week has been, to put it mildly, confusing. But on May 19th, a week after the election result and a whole month after polling started, it at last was clear that Mrs Gandhi would not consent to be sworn in as prime minister, all attempts by the party to change her mind having failed. In her place, the new prime minister is to be Manmohan Singh, the architect of India's economic reforms in the early 1990s. He will head a coalition government that is itself in a minority in parliament. Not much else was clear as *The Economist* went to press: not the make-up of Mr Singh's coalition cabinet; nor the details of the common platform he will be obliged to adhere to if he is to retain the backing of India's Communist parties, on whose support he depends; nor the implications for Pakistan and peace. Little wonder that traders have been making hay, driving the Mumbai stockmarket down a panicky 11% on May 17th, then up a happier 8% the day after.

The worries relate mainly to the fate of India's economic reform under the new management. But the markets should relax a little. In 1991, when Congress last took office, it was in an almost identical position to the one it finds itself in now: short of a majority, and forced to depend on the support of Communists from outside its coalition. Then, as now, Mr Singh was the chief reformer, though the party was led by P.V. Narasimha Rao, a septuagenarian poet with, at the time, no known enthusiasm or aptitude for reform. All the same, the Rao/Singh government lasted five years, during which it smashed the “licence raj” that had smothered the economy in regulations and condemned it to the sluggish “Hindu rate of growth”, a term now happily consigned to history. That government started to privatise, opened India to foreign investment and began to deregulate the country's appalling infrastructure. Over the past six years, the ruling Bharatiya Janata Party (BJP) merely continued Congress's work, with plenty of backtracking along the way. By the time of this latest election, the BJP's privatisation programme was restricted to selling off minority stakes in profitable businesses to eager buyers.

This suggests that there is plenty of reason to hope for better from the new team. As for the Communists, they should be judged by what they do, not what they say. In West Bengal, where Communists run the state government, 15 state-owned enterprises are being sold off, and IT companies have been designated as “strategic”, meaning that their workers are banned from striking. Despite dismissing Congress economic policy as no better than the Hindu nationalists of the BJP, the Communists have worked with Congress before, and should have no difficulty doing so again.

The real problem is that the Communists have chosen to remain outside a new government. Joining would have entitled them to cabinet representation and provided a chance to put some of the good ideas they have followed at state level—on local democracy, health care and literacy—into practice throughout India. The policies of these parties need not clash with reform. The proceeds of rapid privatisation could, for example, be invested in the sort of grass-roots human development that has worked so well in Kerala, where the Communists are strong. That would appeal to both sides of the coalition, and to foreign investors as well. Sadly, the Communists put local interests first (they are rivals to Congress in two key states), and so chose to stay out. But with luck, the result could be the same: bolder deregulation, combined with more attention to the 700m Indians who live in rural areas, far from call centres and cappuccino bars. This is precisely Mr Singh's philosophy: that government should remove itself from all of the things it does not do well, which means pretty much anything to do with business, and concentrate

its efforts on areas where markets alone do not provide the answers.

As Mr Singh's chances waxed during the week, the Bombay exchange rapidly recovered from its fright. And well it might. Whereas the BJP were always reluctant reformers, Mr Singh is the genuine article, a man who understands better than any other leading Indian politician the scope of what still needs to be done. This needs to include plenty more privatisation, tackling taboos such as the oil companies, the national airline and the banks. The essential but delicate task of chipping away at India's mountain of inefficient subsidies—which would allow vast sums to be spent instead on improving India's physical and human infrastructure—has not even been started. Most pressing of all is the country's fiscal mess: its deficit runs at 10% of GDP and absorbs far too much of its budget. But reducing this will be tough: neither widening the tax base nor cutting spending looks easy, especially with the Communists to convince. Still, Mr Singh has performed miracles before. When he took over as finance minister in 1991, India's foreign exchange reserves had sunk to $1.2 billion, or three weeks of imports. When he left office in 1996, they stood at $18 billion, and the economy had grown by an average of 5.6% during those years, far better than before.

Politics turn sour

Ideally, Mr Singh would be able to rely on help from the BJP, which says that it wants all these things too. In reality, this is highly unlikely. For there is not much doubting that Indian politics have taken a nasty and confrontational turn. The BJP's hysterical reaction to the prospect of Mrs Gandhi's appointment has, if nothing else, revealed just what an unpleasant and xenophobic party it fundamentally is, despite the appearance of moderation in which Atal Behari Vajpayee cloaked it. It is true that in most countries a foreign-born leader would be hard to imagine. In America it would be illegal. But India's constitution explicitly permits it, and the issue had been thoroughly ventilated before the voters had their say.

Nor is Mrs Gandhi just any foreigner: she lost both her husband and her beloved mother-in-law, both prime ministers of India, to assassins. In the recent election campaign she showed herself well able to run rings around the BJP, and its boast of a “shining” India, in fluent Hindi. To boycott her swearing-in, as the BJP threatened, shows a contempt for the democracy that is India's proudest achievement. And it was, incidentally, a trifle odd for L.K. Advani, the BJP's leading hard-liner and the former deputy prime minister, to have been part of the boycott planned if she became prime minister. He was born in Karachi (though it was part of British India at the time).

Unfortunately, this may be only the beginning of the BJP's return to bad old ways. Already, voices within the ranks of the Rashtriya Swayamsevak Sangh, the Hindu-nationalist mass movement on which the BJP depends, are blaming the loss of the election on insufficient promotion of *Hindutva*, or “Hinduness”. What does this actually mean? On past evidence, more revision of school textbooks to deny the contributions that the Muslims have made to India; more pressure to tear down mosques and replace them with temples; an end to the “special” autonomous status of Kashmir, for what that is worth; and ultimately, one may be sure, more blood.

Even if the rabid element in the BJP can be restrained on these points, there is reason to fear that another casualty of the election may well be the welcome détente with Pakistan that Mr Vajpayee engineered. If it is to last beyond August, when the two countries' foreign ministers are to meet, and when the status of Kashmir will need to be discussed, Pakistan needs to be given a few concessions. But if hard-liners are ascendant in the BJP it may be difficult for a minority Congress government to grant them. On the other hand, Mr Singh is a Sikh, and Sikhs occupy a special position in the subcontinent, because their religion draws on both Islam and Hinduism. That might just qualify him to make a historic breakthrough. Should Pakistan and India go back to raining abuse, or shells, on each other, the new prime minister's ambition to make this the “Indian century” will become very much harder to achieve.

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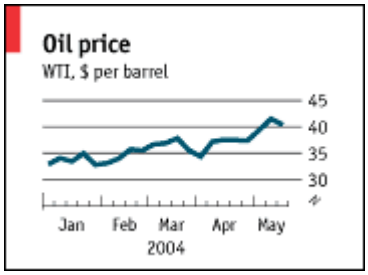
Oil

Still at its mercy

May 20th 2004
From The Economist print edition

The world economy remains vulnerable to the price of oil



TURMOIL in the Middle East is once again helping to unsettle the market for oil and testing nerves in central banks and economics ministries. As *The Economist* went to press this week, the benchmark price of crude had subsided a little from the high it touched on May 17th, but at around $40 a barrel, oil is still dear enough to make economic policy much more complicated than anybody except OPEC would have wished during the next few months.

It is true that even at $40 a barrel, oil is still far cheaper in real terms than it was during the spikes of the 1970s. But don't relax too much: oil caused a worldwide slump back then, let's not forget. At the current price, oil may be incapable of causing mass unemployment, double-digit inflation, extraordinary political turmoil and losses of global economic welfare on a scale hitherto associated with total war—but just how reassuring is that? If oil is only $10 a barrel higher than it would otherwise have been, and stays there a while, prices in general will rise, output and incomes will be reduced, and unemployment, at least for a while, will be raised. That vicious combination of higher inflation and lower growth—stagflation, to recall a term from the 1970s—is about the worst scenario an economic policy-maker can contemplate. Economies may not be as exquisitely sensitive to oil as they were 30 years ago, but make no mistake, oil still matters (see article).

Predict at your peril

What is driving the increase, and how much worse might things get? Reading the oil market is never easy. Forecasting the price of oil, as this newspaper can readily attest, is a dangerous enterprise. Still, a couple of things, at least, are plain. For a start, shortfalls in supply are not the immediate cause of the recent run-up. You might be forgiven for thinking otherwise: OPEC, under heavy diplomatic pressure from the United States and other countries, is debating whether to increase its output quotas in order to dampen the price. That seems to suggest that supply is the issue. But not really. Production is already high. OPEC is currently exceeding its quotas; with the notable exception of Saudi Arabia, which could bring further production on-stream quickly if it chose, the cartel's members are producing flat-out. And at $40 a barrel, well they might.

The debate over quotas is not about how much more oil to put on to the market next week, but about what signal to send to their biggest consumers, and each other, regarding the medium-term future. The balance they want to strike is between, on the one hand, avoiding the appearance of caving in to pressure from America for lower prices and, on the other, deflecting measures aimed at economising on the use of oil which would trim their longer-term incomes. None of this has much to do with short-term supply.

If that is not the issue, what then has caused the recent rise in prices? Three related things, or so it seems: surging demand; petroleum-distribution bottlenecks, especially in the United States; and speculation aimed at pricing in the risk of some big future setback in supply. Demand is high worldwide at the moment, because growth in the world economy is strong. This is especially so in America, with its apparently vigorous economic recovery and the approach of the summer “driving season”. But oil that is in principle available to meet this demand is being held up by blockages in domestic petroleum-distribution channels. This drives up gas prices, which in turn washes back on the underlying commodity. This should be temporary, however. Before long the blockages will clear, the gasoline market will stabilise and the underlying balance of supply and demand, consistent with a much lower price than $40

a barrel, should reassert itself in the market for crude.

This still leaves the third factor: the risk of future interruptions in supply. This is where the real danger resides. Part of the problem is that the prospect of a secure resumption in Iraqi supply is receding: the country is far from pacified, and some oil investors are doubtless betting that things may yet get worse. More important, however, is the new risk of a severe and lasting interruption in Saudi supplies. Terrorists in the kingdom have begun to strike at energy targets—a shrewd tactic. Perhaps it is unlikely that they will succeed in curbing supplies by much or for long, but Saudi Arabia is so overwhelmingly important to the global oil market that even a small risk of a very bad outcome is enough to justify a substantial "terror premium". Those who watch the oil market reckon that this is currently worth between $4 and $8 a barrel. An intensification of terrorist efforts, or one spectacular success, could drive that up a lot. Needless to say, if al-Qaeda actually succeeded in shutting Saudi production down, prices would rocket, and comparisons with what happened in the 1970s would no longer be idle.

In short, sensitivity to oil continues to bedevil the world economy. Incomes and jobs around the world still hinge on the price of a commodity which comes chiefly from extremely unstable parts of the world, supplied through a market that is rigged at every turn. When the price does next subside, and the opportunity again arises to use taxes to weaken OPEC by discouraging western consumption of oil, America's government, especially, might bear this in mind.

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Russia

Putting up with Putin

May 20th 2004
From The Economist print edition

How to live with a Russia that is not a liberal democracy

AP

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WHAT is Russia becoming? The question has bothered foreigners for centuries, but never more than in the past 13 years. Russia-watchers looked on in elation as communism crumbled and the Soviet Union fell. Under President Boris Yeltsin, Russia struck out on a journey that many hoped would leave its long authoritarian tradition behind forever.

Instead it went through a period of rip-off privatisations, rigged elections and endless, impenetrable politics. The economy experienced collapse, stagnation, boom, bust and now, at last, seemingly more solid growth. And Russians today overwhelmingly support President Vladimir Putin, who seems determined to get the country back on its feet but has little tolerance for criticism, whether at home or abroad.

During this time, western leaders have gone from arguing that Russia was becoming a democracy, to pretending that it already was one, to getting upset over mounting evidence that it was not. Mr Putin's penchant for suppressing rogue television channels, imprisoning enemies, manipulating elections and generally increasing the Kremlin's grip has fuelled dire warnings about a relapse into autocracy.

It is time to take a final step: to accept that the hopes of the 1990s were misplaced, and that Russia will take many years to become a liberal democracy. As our survey in this issue argues, Mr Putin's rule has become a hybrid of economic liberalism and political illiberalism. That Mr Putin governs as he does, and is popular for doing it, does not mean that he is a power-mad dictator or that Russians are mindless slaves. It is, to a large extent, a consequence of what came before.

This is not to say that Russia does not need liberal democracy. On the contrary: the lack of checks and balances is directly damaging the economic success that Mr Putin craves. But Russians know that the democracy they were seemingly given in 1991 was an empty shell. They will get the real thing only by building it, slowly and painfully, as they realise from bitter experience that they need social activism and a political voice to protect their growing prosperity. The right question now is not whether or when Russia will become democratic. Rather, it is how rich Russia's present system can make it. Westerners like the idea that prosperity and democracy go hand in hand, but they forget that many countries spent a long time developing the first before getting to work on the second; some, particularly in Asia, quite successfully.

Sadly, Russia is not such an orderly place as Singapore or even South Korea; and its respect for the rule of law and for property rights is inconsistent, to say the least. Prosperity and freedom tend to go together in large measure because democracies have strong guarantees for these things. Economically successful authoritarian states have generally provided similar guarantees not through democracy, but through well-run legal systems, an efficient bureaucracy and clear legislation. Russia has a corrupt legal system, a monstrous bureaucracy and laws like thick mud. Mr Putin's plan to wean the economy off its excessive dependence on natural resources depends on fixing these failings, but it is not yet clear that he has either the will or the ability to deliver.

How can the West help?

By changing attitudes, without changing demands. Lecturing Russia for breaches of human rights in Chechnya or for suppressing free speech goes down badly. But western concerns about lack of freedom can be expressed as worries that a quixotic application of the law could be a big obstacle to Russia's own development. At summit talks, this is often said. What is lacking is more regular contact at lower levels of government that could influence the innate conservatism of Russian officialdom that tends to reinforce Kremlin control. Such contacts could also nurture the sprouting of liberalism from the grass-roots level.

Co-operation can grow in many areas, from Russian internal problems that spill over its borders (drugs and human trafficking, infectious diseases) to world economic issues (Russia and the European Union are on the verge of a breakthrough that may lead to Russia's accession to the World Trade Organisation). Expansion of the European Union and NATO have led to new tensions over Russia's neighbours and further emphasised Russia's differences with the West. But such differences should not become an excuse for isolation. Russia needs to learn to see the West less as a threat and more as a possible source of help. It may take a while to convince officials that such things as western-backed pro-democracy programmes and civic groups, which Russia has fiercely discouraged, are meant to strengthen the country, not subvert it. But if mutual suspicions could be overcome, prosperity and democracy would come to Russia that much sooner.

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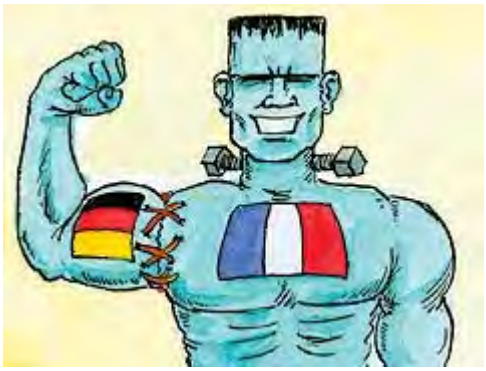
National champions

Bravura nonsense

May 20th 2004
From The Economist print edition

France and Germany are quite wrong to embrace the idea of industrial champions



YOU have to hand it to the French government: it certainly knows how to lay down a smokescreen. By persuading Germany to lend its support to a proposed initiative that will succour Europe's companies by helping them to become “champions”, France distracted attention from its long and dismal record of interventions in markets, mergers and acquisitions involving French companies. It also sent out a thoroughly unwelcome signal to the European Commission, which has struggled to make coherent and sensible competition and merger policies. It is obvious why France would do this. Far less clear is why Germany might join in (see article).

France's record speaks for itself. Nicolas Sarkozy, the newish and reform-minded finance minister, has already shown he cannot resist his ministry's long tradition of meddling. This week he put the finishing touches to a big rescue plan for Alstom, a near-bankrupt engineering group. Earlier rescue efforts had been blocked by the European Commission on the grounds that they constituted unfair state aid. After some haggling, Mr Sarkozy emerged with a deal that, for the moment, excludes the sale of Alstom's gas-turbine business to Germany's Siemens. Siemens wants that business in order to compete more effectively against America's General Electric. Under the logic of champions, that surely constitutes a strong motive for Franco-German co-operation? Alas, no. Mr Sarkozy's behaviour suggests that if Europe must have its champions, then let them only be inside fortress France.

Another recent case shows how far France is willing to go to protect what it sees as its national, as opposed to European, interests. Aventis, a Franco-German drug company, is merging with Sanofi-Synthélabo, a bigger French rival. But the deal is going ahead only after the government made it clear that it would not accept offers from non-French bidders—Novartis, a Swiss firm, had indicated it might bid. (Contrast that with Britain's willingness this week to allow Celltech, its biggest pure biotech company, to be bought by a Belgian rival.)

Time for Germany to say no

So do the Germans really believe in the need for champions? It is true that Gerhard Schröder, Germany's chancellor, recently seemed to encourage Deutsche Bank to buy Postbank, the banking arm of Germany's postal operator. Equally, RWE and E.ON have been indulged as they have become two of Europe's biggest energy groups. And governments have tried to find local solutions for troubled businesses, such as Kirch and Philip Holzmann, to name but two. But these cases are counterbalanced by others, in particular the lack of interference when Britain's Vodafone bought Mannesmann. On balance, the Germans have intervened less than the French.

It does not follow that the latest rhetoric is therefore more amusing than dangerous. Europe does need strong companies to compete in increasingly global markets. But the way to nurture them is not to wrap them in cotton wool and to step in with help every time markets are tough. The French and German car industries offer a good example of how companies can compete successfully without government's looming presence. Equally, Italy's struggling Fiat shows how damaging long-term props offered in the name of local champions can be. Germany should refuse to enter any pact with France and expose what really underlies the champions debate: traditional and predictable French self-interest.

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Brown v Board of Education

Change gotta come

May 20th 2004
From The Economist print edition

Fifty years on, America needs to give poor black parents more choice in education

AP

VERY few court decisions can justly be described as historic. *Brown v Board of Education of Topeka, Kansas* was one. On May 17th 1954 Chief Justice Earl Warren announced that the Supreme Court had decided unanimously “that in the field of public education the doctrine of ‘separate but equal' has no place.” America should desegregate its schools to give black children the same opportunity as white ones.

Brown was in fact less clear-cut than it looked. Rather than being one decision about one district, it was actually two about five. And rather than abolishing segregation forthwith, the justices sought advice on how to do it, thus starting a process of delay that southern states exploited. Yet *Brown* still marked the beginning of the civil-rights revolution. It emboldened blacks to push forward, to dream—as Martin Luther King did famously eight years later—that their children would “one day live in a nation where they will be judged not by the colour of their skin but by the content of their character”. And it persuaded white politicians and judges to remove the legal underpinnings of segregation.

So rejoice this week on *Brown*'s 50th anniversary: by any measure, America is a far less racist place than the country was when Warren issued the judgment. Indeed, the change in the status of blacks (and other minorities) has been such that this newspaper has for some time argued that the policies of “affirmative action” that were adopted in the 1960s are now harmful. Judging people on the colour of their skin looks outdated—particularly now that America is a multicoloured place rather than the two-tone, black-and-white country that *Brown* upset.

Yet amid this success stands a cruel irony: too many American schools are still separate and unequal, with black and Latino students often stuck in rotten, overcrowded, underfunded classrooms. And the public school system has been resegregating. The question is what to do about it. A generation ago, school districts tried forcibly “busing” poor black students to white suburban schools. This social engineering created a backlash, which was reflected in Supreme Court decisions giving first schools and then school districts the chance to opt out. In 1992, the court ruled that “racial balance is not to be achieved for its own sake”.

That, surely, remains a good principle. A *Newsweek* poll shows that 57% of black parents do not care about a school's racial composition. They care about the fact that their schools have less money and worse teachers than white ones (and the poll shows that this vexes whites as well). The issue is complicated by the fact that public education is paid for locally, so the disparity between schools within a district is usually less significant than that between districts: schools in Beverly Hills get $1,000 more per pupil than their neighbours in the rundown Los Angeles Unified school district. State governments—or conceivably even the federal government—could do more to even this up.

Yet more money is far less important than structural reform. America spends more on its schools than other countries but gets worse results. And there is a more immediate way of stirring up the system in the way *Brown* intended: school vouchers. These would enable poor parents to choose their children's schools (including, controversially, private and religious schools) thus promoting competition to attract pupils. Blacks and Latinos support the idea by large margins. It is opposed by a mixture of Democratic politicians (who take the teachers' union shilling) and conservative white suburbanites, who fear ghetto

children coming to their gleaming schools. But there is a big difference between busing and vouchers. The former was government-directed and explicitly based on race; vouchers are driven by choice and by the need to improve schools. They deserve a chance.

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Britain's Olympic bid

Spoilsport

May 20th 2004
From The Economist print edition

Do London a favour: give the Olympics to Paris

NOW that the shortlist for the 2012 Olympics has been announced, there will be a great banging of national drums as statesmen and sportsmen in London, Paris, Moscow, Madrid and New York unite to make their case. *The Economist* would like to make its case, too: please, please can we not have the Olympics in our home town.

This is not just the usual curmudgeonly British determination to spoil everybody's fun, nor is it another manifestation of the country's tendency to run itself down. Britain may not be much cop at winning the sporting events it hosts (its remarkable haul of golds in the London Games of 1908 was won partly by re-running events won by Americans) but it is good at organising them. Wimbledon, the British Open golf championship and regular cricket test matches tend to pass off rather well despite the weather.

There is little doubt that London could do the Olympics proud if it got them. What is less clear is whether spending a couple of billion pounds of public money on having an extra half a million people in town for a few weeks sounds like fun. The British public is not convinced (see article).

Warm feelings and hot air

Those pitching for the Games to be held in London make two different sorts of argument. One rests on “intangibles”, which include national morale and various sorts of “spirit”, such as “community” and “Olympic”. Cities that have hosted the Games are said to have benefited from infusions of warm feelings. Since they are conveniently unquantifiable, arguments relying on them sound suspiciously like hot air.

The economic case for holding the Games in London rests on two ideas: first, that they will lead to a lot of investment from which the host country will benefit for years to come; second, that they will bring an economic boom. Neither stands up to much scrutiny.

The Olympics may well lead to investment that would not otherwise happen. The question is whether it should. If neither private nor public sectors have yet got round to building an Olympic-size stadium or swimming pool in London, nor to regenerating the lower Lea Valley (site of the proposed Olympic village), that is probably because those projects don't make economic sense. Holding the Olympics doesn't much improve the economic case for them, as the expected £2.4 billion ($4.2 billion) public subsidy suggests.

As to the economic boost the Olympics could bring, that argument may wash in a second-level city seeking to win attention for its nascent tourist industry or to mop up a labour surplus (such as Barcelona). But London is already on the tourist and economic maps. Conditions on its sardine-packed underground argue against the flood of extra travellers the Olympics would bring. Its labour market is already tight (unemployment in the city is running at 3.5%) and anybody who has recently tried to get a builder may question the need for an injection of demand into the construction industry.

But if taxpayers and commuters are unlikely to benefit, there is one class of people that relishes the idea of holding a big party and sending the bill to the exchequer: the politicians, in particular London's left-wing mayor, Ken Livingstone. Getting the Games would give him an excuse for slapping an extra charge on the council tax and extracting more money from the Treasury. Let us hope that the International

Olympic Committee does not indulge him.

Luckily, London seems unlikely to win. Paris is the bookies' favourite by some distance. In the traditional spirit of Anglo-French feeling, we pray that it will triumph.

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Letters

May 20th 2004
From The Economist print edition

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Google's search for cash

SIR – You miss the target regarding Google's initial public offering ("A cartel-buster", May 8th). You state that bankers during the dotcom bubble underpriced IPOs, leaving companies short-changed. Surely, if a charge can be levied against those bankers it is that they overpriced these IPOs. As to the companies being victims of greedy bankers, one must assume that they were willing victims.

Companies are prepared to pay handsomely and with no questions asked to get the best names in banking on to their prospectus, just like film producers are prepared to pay silly sums of money to attract big-name actors and increase their chances of a blockbuster movie. Similarly, firms are prepared to leave a lot on the table to increase the chances of being able to come back for more if they need to.

What is silly is that bankers, who should be conscious of their reputation in the long term and therefore exercise checks and balances on the capital-allocation process, are making so much money that they don't give a damn. In that respect, leaving retail investors to set the price is more an abdication of responsibility than a cure. This can only encourage some of the valuation excesses of the late 1990s, which are back in fashion just five years after the bubble burst.

Jean-Michel Deligny
London

ITV's licence fee

SIR – Your article on the BBC includes the comment that "ITV, Channel 4 and Channel 5 also receive public money" ("Reining in Auntie", April 24th). ITV does not receive any public money. On the contrary, last year ITV paid in excess of £200m ($330m) to the Treasury in the form of licence payments. Over the past decade, the ITV companies have collectively paid several billion pounds to the government for access to analogue spectrum, the value of which has been hugely eroded by the launch of digital television. ITV's main competitors for audiences and revenues—the BBC, Channel 4 and BSkyB—make no equivalent payments for their licences. The best way for Ofcom, Britain's media regulator, to ensure that the BBC faces enduring competition on quality would be to abolish this punitive tax on ITV and thus free significant additional funding for investment in British programming.

Christy Swords
Director of regulatory affairs
ITV
London

Food for thought

SIR – Not everything in life can be measured in economical terms, as some economists may suggest. You try to quantify the loss to society as a consequence of hunger and justify why we should do something about it based on economics (Economics focus, May 8th). We should help the poor because it is the right thing to do, not because it will improve trade.

Wandreson Brandino
Sydney

SIR – You seem to agree that there is no single “magic bullet” for hunger. Wrong. Every country in modern history with market-oriented institutions—most notably, secure private-property rights—is immune to the famines and persistent hunger that plague much of sub-Saharan Africa, North Korea and other places lacking reasonably free markets. Markets may not be magic but they are a sure cure for hunger.

Donald Boudreaux
Fairfax, Virginia

Bright ideas

SIR – You say of innovation that big firms should continue to pick up new ideas from smaller ones (“Less glamour, more profit”, April 24th). I would add two further points. First, there is a growing and welcome trend for companies that depend on technological and scientific leadership as well as innovation to partner research-intensive universities, as one plank of their strategy to keep ahead.

Second, small companies are likely to contribute more breakthrough ideas, as there are more people with the necessary insight working in smaller companies. Also, many creative individuals believe, rightly or wrongly, that they will find it easier to benefit from commercialising a new idea by setting up their own company than by persuading a large company to take on the idea while it is still in embryonic form.

Christopher Padfield
Cambridge University Corporate Liaison Office
Cambridge

Firm of mind

SIR – The makers of the film “The Corporation” were unfailingly polite when they interviewed me and asked permission to use a part of the film that demonstrators made at our house (Face value, May 8th). But you overlook a critical flaw in the film's argument. The central proposition that corporations have taken over some of the legal persona of individuals is something that we recognise in practice. Corporations do indeed have recognisable group personalities that are built collectively by the people who work for them, so treating each company as a person is not unreasonable.

However, I would not accept for a minute a verdict of psychopathy based on a selective combination of characteristics of half a dozen different individuals. By similar selection of characteristics of different organisations, I could “prove” an equally false profile of NGOs or unions. In effect, you commit the same error by concluding that governments and state ownership result in greater harm than corporations. There are good and bad companies, governments, NGOs and unions. Stereotyping does not help the good ones to work together, as they must if we are to repair the deficiencies in our societies.

Sir Mark Moody-Stuart
London

SIR – Perhaps it is better to compare the corporation to a sociopath, not a psychopath. Psychopaths are psychotic: they suffer from delusions and hallucinations, and often have a difficult time functioning in society as a result. They are confused, inconsistent, insane. Sociopaths are not confused and disturbed. They are, however, fundamentally self-absorbed and self-promoting. They lack the capacity for empathy, and relentlessly act in their own interest while discounting any other people or points of view. They are not insane, merely inflexible and inhuman; they are often described as antisocial because society finds their self-serving actions and logic abhorrent. Comparing a corporation to a sociopath would be much more apt.

Lisa Mills
Boston

Past caring

SIR – I have to wonder about the book review that states of Alexander Hamilton that “most Americans know him as their country's first treasury secretary” (“A maker of America”, May 8th). Would that it were true. The state of American history is such that most Americans, especially younger ones, would not know who Hamilton was if they were stuck with him in a stalled lift. Even fewer could tell you if

Presidents Garfield and McKinley were shot, poisoned with bad moonshine, done in by a jealous husband or hit over the head with a baseball bat.

Joseph Frazier
Portland, Oregon

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Gay marriage

Another Thirty Years War in the making?

May 20th 2004 | CAMBRIDGE, MASSACHUSETTS
From The Economist print edition

Reuters

The first legal same-sex marriages have finally taken place. A long struggle between gay activists and social conservatives lies ahead

Get article background

SELDOM in recent times has a clerical act inspired so much jubilation. One second past midnight on May 17th, gay marriage became legal in Massachusetts, and same-sex couples began to fill out marriage licence applications in Cambridge City Hall, specially opened for the occasion. Well into the wee hours, a huge crowd remained outside, throwing rice, blowing bubbles, and greeting each new couple as a pair of conquering heroes.

War is an appropriate metaphor. Supporters, pointing out that May 17th was the 50th anniversary of *Brown v Board of Education,* claim the ceremonies in Massachusetts mark the biggest advance in civil rights since racial segregation was abolished. Conservatives, who see “the end of western civilisation” in the marriages, look back to 1973 and another Supreme Court ruling: *Roe v Wade*, which legalised abortion and started a culture war that has lasted for 30 years.

If “life” has been one talisman of the American right, this week “family” became another. Once again, claim conservatives, “activist judges” have trampled over the views of decent Americans. Now they will take the battle to courtrooms and legislatures around the country.

Certainly, the full legalisation of gay marriage in Massachusetts took many liberal activists by surprise. Gays had spent the past decades slogging through state legislatures, fighting for far more modest gains such as health benefits for domestic partners and anti-discrimination laws. Many assumed Vermont's civil unions (non-marriages with most of the legal advantages) would be the best they could get.

Then last November, in a four-to-three ruling, the Massachusetts Supreme Judicial Court issued its decision. Based on the state constitution's promise of equal rights, gay couples must be allowed to marry. The court gave the state six months to implement the ruling—which set this week's starting point. Its ruling also emboldened several liberal cities, notably San Francisco, to start marrying people—but those unions are under a legal cloud. The marriages this week were the first unequivocally legal

ceremonies.

The right's reaction was less militant than might have been expected. Five stern Baptists from Kansas came to Cambridge holding belligerent signs, but they were largely ignored by the crowd. Only about 50 demonstrators showed up at Boston's city hall to protest about “Marriage Destruction Day”. Even in the state's less liberal towns, gay couples were treated politely, with standard New England reserve, by clerks and bystanders. The staff were following the orders of the Republican governor, Mitt Romney, who had ruled that the law should be respected.

Yet the counterattack is only just around the corner and may precipitate years of conflict. Mr Romney is trying to enforce a long-neglected 1913 state law—last associated with bans on interracial marriage—that denies marriage licences to out-of-state couples whose home states would outlaw their unions. He has already demanded details of marriages in four liberal towns that had proclaimed their willingness to defy him on this issue. Conservatives are also mumbling about gay couples who only fulfil the residency requirements through second homes.

Only a handful of liberal states, including Connecticut, Rhode Island and New York, have suggested they might honour same-sex marriages performed in Massachusetts. By contrast, 39 states have passed laws restricting marriage to heterosexual unions. Rows about which states should recognise which marriages will now start sprouting up in state courts around the country; some of them will surely end up at the Supreme Court.

In the meantime, conservatives in Massachusetts want to push through an amendment to their state constitution. A compromise amendment, which banned gay marriage but legalised Vermont-style “civil unions”, passed through the state legislature earlier this spring. But it still requires another legislative vote and a statewide referendum—and could not take effect until at least 2006. Given the general air of acceptance this week and the public fatigue over months of legal wrangling, conservatives might find it a tough vote to win.

Even if Massachusetts accepts gay marriage in two years' time, it is unlikely the country will. National polls show most Americans oppose it, and Republicans think they can use the issue to galvanise the conservative base this year. Various ballot initiatives are planned around the country, the idea being that they will draw to the polls the social conservatives who supposedly stayed at home in 2000. Republicans will also point out that John Kerry hails from Massachusetts and the Democrats' convention will take place this summer in Boston.

Mr Kerry has spent months trying to finesse a position that might satisfy both sides. He opposes gay marriage, but he also opposes a federal constitutional amendment that would define marriage strictly as the union of a man and a woman. George Bush supports the federal amendment, which is unlikely to get through Congress this year, but he has not exactly been glib on the subject, either: his advisers are aware of the need not to sound intolerant.

Jonathan Rauch, the author of a new book arguing the case for gay marriage, points out that America no longer really has a national consensus about what marriage means. In a recent *Los Angeles Times* poll, 24% of Americans said that gays should be allowed to marry, and 34% opposed any form of legal union for same-sex couples; but the biggest number—38%— plumped for civil unions. There is also a generational divide: among 18-29-year-olds, support for gay marriage rises to 44%, with an additional 31% wanting civil unions. And while Americans overall narrowly favour a constitutional ban on gay marriage, youngsters oppose it by a margin of two-to-one.

This explains why Mr Bush and Mr Romney have tended to fix on the notion of democracy: dramatic social changes of this nature, they say, should be made by legislatures and voters, not judges. But the religious right has felt freer to rail against what they say is a symbol of moral decay. Some even seem to welcome the arrival of the marriages as their enemy being revealed in its true colours. Civil unions are much harder to condemn.

Yet even as both sides prepare for another mighty culture war, there are some grounds for hoping that this will be less vicious than the abortion conflict. Terminating a pregnancy, as even defenders of abortion admit, is a fairly grisly affair. Gay marriages may prove easier to live with. The true test of this week's advance may come when the issue disappears from the headlines, and newly-wed couples return to their homes and jobs—and heterosexual Americans start to ponder just how dramatic this social shift really is.

One optimistic example might be inter-racial marriage. In the last century these created all sorts of legal tangles, with mixed-race couples from the South going north to get married, and then being arrested on their return home. Now the racist laws have gone; but so too has much of the oddness of it all. And that remains the best hope for gay marriage. For all the noble speeches this week from gays expressing their fundamental rights, their cause may yet draw most power from the mundane, and decidedly unapocalyptic, details of everyday life.

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The electoral week

On the trail

May 20th 2004
From The Economist print edition

Positive mental attitude

“I've stopped reading the newspapers. You've got to keep your sanity somehow. I'm a survivor.”

Donald Rumsfeld in Iraq, May 13th

It's all the feminists' fault

“I particularly am upset about the way the feminists have taken really large strides in the military...the women had no business guarding Iraqi prisoners.”

Phyllis Schafly, the grand old woman of the right, on the real reason to be upset about the photos from Abu Ghraib. Capital Report, CNBC, May 13th

Peace, man

“We were denied in four days. We think that's a record. Now we plan to open a welcome centre staffed by punksters and anarchists and squatters. We just want to help out.”

John Penley of the Youth International (Yippie) Party, which planned to offer massages and medical marijuana during the Republican Convention in New York. It was denied a permit to camp on the Lower East Side. Washington Post, May 17th

A question of taste

“No matter how many times he comes down here...he's still a guy who drinks Perrier and Dom Perignon instead of Pepsi and Pabst Blue Ribbon.”

Mike Huckabee, Republican governor of Arkansas, on John Kerry's visits to the state. Boston Herald, May 13th

Christmas comes early

The White House's annual financial disclosure of gifts revealed that Vice-President Dick Cheney received $6,345 in gifts, including a set of designer earrings and necklace valued at $1,475.

Reuters, May 14th

Clueless in St James's

Last week we published a list that purported to show the IQs of states voting for George Bush and Al Gore in 2000. Alas, we were the victim of a hoax: no such data exists. By way of apology, here are two very crude ratings of states' intelligence—and how they voted.

Lock up your daughters (1)

“I think they may have some involvement in the campaign, which will be fun.”

Laura Bush on her daughters, who graduate from college this summer. Road to the White House, C-Span, May 16th

Lock up your daughters (2)

“It was a lovely photograph, but not a single vote is going to be cast based on the naked appearance of his daughter. Those people who care about that deeply are probably not Kerry voters.”

Tony Blankley, of the conservative Washington Times, snorts about Alexandra Kerry's see-through dress at the Cannes Film Festival. New York Daily News, May 18th

Common man

“For a few years I shared membership in the Teamsters, I was a Teamsters cardholder. I learned how to wheel one of those electric carts around with a pallet filled up to the top, and take those turns, and race with other people.”

John Kerry reveals that he was once a union member during a summer job between terms at Yale. New York Times, May 17th

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Grass-roots politics

The ersatz Democrats

May 20th 2004 | ST LOUIS
From The Economist print edition

The ragged army that poses a real threat to George Bush

"ARE you a registered voter?" It is 5pm on a rainy Thursday afternoon in one of the tougher neighbourhoods of St Louis. Huddled next to the pumps at a corner petrol station, dressed in khakis and dark sneakers (no jeans or revealing clothing allowed), Marvel Robinson clutches a shiny Palm Pilot and a clipboard and repeats the same question to every customer. If the answer is no, he starts taking down details. "Make sure you vote," he calls after every driver has filled up.

Voter registration is one of the oldest grass-roots jobs in politics, particularly for the Democrats, since many of their natural supporters—poorer people and minorities—are those least likely to be registered. For generations, activists have pounded pavements and knocked on doors. This year, however, things are different. The footsoldiers are better organised, they are using more sophisticated technology and they have nothing—formally—to do with the Democratic Party.

AP

Working alongside Mr Marvel

Instead Mr Robinson and hundreds of people like him are paid to register voters by a new organisation called "America Coming Together". ACT is one of a number of new political organisations known as "527s" (after the section of the tax code that governs them) created by Democratic activists in an attempt to boost their chances in November. ACT claims to be the biggest, most well financed and sophisticated voter-registration campaign in American history. A sister organisation, the Media Fund, makes and pays for political ads. An umbrella fundraising group called the "Joint Victory Campaign" channels money to both. Along with other smaller 527s, these groups are the ersatz Democratic Party.

Their creation was a reaction to the McCain-Feingold campaign-finance law of 2002, which raised the limits on how much "hard" money an individual could donate to a particular political candidate, but prohibited parties from raising "soft" money to support issue campaigns (that just so happen to nail your opponent). This change hurt the Democrats in particular, as Republicans have always been more successful at raising "hard" money.

The 527s get around the soft-money strictures since they do not endorse or campaign against a particular candidate. Rich Democrats thus have a vehicle to make big donations: for instance, Steve Bing, a rich Hollywood liberal, has given more than $8m to these 527s; from Wall Street, George Soros, a wealthy financier, has handed over almost $8m.

To make things yet murkier, some 527s, including ACT, are technically hybrids: they raise and use hard money for the purpose of defeating federal candidates, and they use soft money for other activities. Distinguishing between the two, of course, is virtually impossible. According to its lawyers, only 2% of ACT's activities are explicitly geared towards defeating George Bush. But look at the outfit's website and you get an entirely different impression. ACT's people are "laying the groundwork to defeat George Bush" it proclaims on the home-page.

Clearly 527s have knocked a hole in the campaign-finance laws—a point not lost on Republicans who were slower to set them up. Despite the Republican complaints of foul play, on May 13th the Federal Election Commission decided to put off for 90 days any ruling on 527s—in effect until after the election. Senators John McCain and Russ Feingold, the architects of the 2002 law, have both accused the FEC of failing to close a loophole that "dangerously undermines the purpose of campaign-finance laws".

In fact, somebody was bound to find a loophole in the new law sooner or later. The real revolutionary effect of the 527 phenomenon has to do with the Democratic Party, which has effectively outsourced its grass-roots operation. This may prove vital for John Kerry, who has been slow to build up his organisation.

ACT alone has taken in almost $20m to date and claims pledges worth almost $60m. Its target is $95m (roughly the same amount as Mr Kerry has raised thus far). It has around 1,000 paid employees working in 40 offices in 15 out of the 17 battleground states. And it is involved in far more than just registering voters.

The canvassers use their handhelds to enter a wealth of information about voters' political leanings and concerns. Using this data, ACT then plans repeat visits (it hopes to see each person several times before the election) and targeted e-mails. In Ohio, the handhelds have “video capacity”, so voters can be shown a neighbour discussing some issue.

Will it work? This sort of approach, argue the ACT people, will be much better than yet more television ads. Steve Rosenthal, ACT's boss, pioneered a sophisticated get-out-the-vote campaign in Philadelphia that won the mayoral election for the Democrats in 2003.

Although the 527s are not (officially) allowed to co-ordinate with the Democratic Party, they can work together. For instance, yet another 527 group, America Votes, is an official partnership between around 30 national pro-Democrat groups—from ACT to the Sierra Club to the AFL-CIO union group. America Votes promotes information sharing and the co-ordination of resources. The idea is to minimise duplication and maximise the efficiency of the voter registration and education effort.

Will this ersatz Democratic campaign be enough to push Mr Kerry into the White House? Nobody knows. But since Mr Kerry has yet to open an office in some battleground states, he would certainly be in a worse state without them.

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About sponsorship

Catholic priests

Breaking away

May 20th 2004 | SEWICKLEY, PENNSYLVANIA
From The Economist print edition

A rebel priest takes his congregation off with him

Get article background

NERVOUSLY, Father William Hausen paces to and fro. It is Sunday, but his parishioners seem too scared to come through the doors to mass. That is not surprising, for he is holding the service in the Sewickley Country Inn, 15 miles from Pittsburgh. At the beginning of this month, the Catholic diocese of Pittsburgh excommunicated the turbulent priest and threatened "grave consequences" for people attending his church.

In the end, 150 people turn up. After a sharp dip for his first Sunday of rebellion, the priest's numbers have held steady. Father Hausen has broken away from the diocese of Pittsburgh, which covers 810,000 Catholics in six counties of western Pennsylvania, to start his own Christ Hope Ecumenical Catholic church.

AP

A rebel in white

He has set up in the banqueting hall at the Country Inn until he gets more money. His "church" has full Catholic ceremonial, with processional crosses, candles and holy water at the door. But Father Hausen means to be shockingly inclusive. He has made it clear that the "priesthood" of his church is open to homosexuals, married people and women. And communion—normally reserved for Catholics in good standing with the Church—may be received by anyone.

The diocese, though it hopes for reconciliation, is not budging. In its view, Father Hausen, who was ordained in 1965, has excommunicated himself. His behaviour has become increasingly difficult ever since, at Easter two years ago, he preached a controversial sermon urging discussion of "real things", such as the ordination of women and married men and the problem of sexual abuse among priests. (Catholics, he said from the pulpit, should be "pissed off" about that.) Last October, he was banned from saying mass and even from calling himself a priest because of drinking problems. Now he is trying to set up an alternative congregation.

Father Hausen and his two young assistants, fresh out of college, say they embrace the Catholic church but not its authoritarian ways (which is rather like embracing a bicycle without the frame). They teach the theology of *agape*, selfless love, and ask parishioners to "construct with love" and "reduce fear and guilt". A bible class, for instance, was about how best to communicate love. His followers, an eclectic group of tattooed men and women in pearls, seem enthralled. "It's so refreshing, real and honest," one elderly parishioner says.

Paul Lakeland, a professor of religious studies at Fairfield University in Connecticut, compares Father Hausen's movement to that of George Stallings, who split from his Catholic diocese in Washington, DC, in 1989 because he felt that blacks were not getting a fair shake in the church. He sees two factors in play. Some parishioners are simply sticking by a priest they like; others are actively defecting because they are mad as hell with the institutional church. And there is much to be angry about. The *Pittsburgh Post-Gazette* reported last month that six lawsuits had been filed against the diocese of Pittsburgh for ignoring and concealing sexual abuse as far back as 1954.

At the service, injured feelings run high. Afterwards, parishioners talk of churches refusing to baptise their daughters, marry their sons or ordain their friends as priests. God loves everybody, one woman

says. Why, then, do the Catholic rules have to hurt? The discussions rage on over coffee and doughnuts well past the allotted hour.

Some expect that Father Hausen's church will quickly disintegrate once followers lose their steam or funds run out. Others expect more such groups to surface. Either way, Father Hausen seems to be taking everything in his stride. He has sold some land in Florida to bring his church this far, and now that he is excommunicated he will lose his pension. If the church doesn't fly, he jokes, he will have to flip burgers for a living. Then he is serious. “If I don't work as a priest,” he says, “I really don't know what else to do.”

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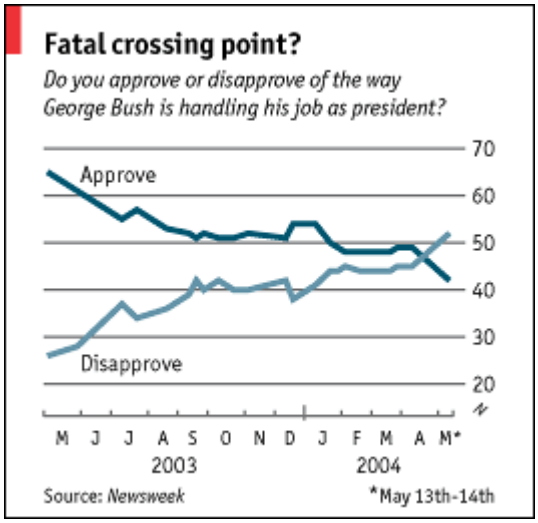
Donald Rumsfeld

What did he know?

May 20th 2004 | WASHINGTON, DC
From The Economist print edition

A chain of command seems to be established



WHEN George Bush went to the Pentagon and described Donald Rumsfeld as the best defence secretary America had ever had, it seemed that the old curmudgeon would ride out calls for his resignation. That is still the likely outcome. But this week, Mr Rumsfeld's explanation of the prisoner-abuse scandal in Iraq—it was all the work of a few bad apples—was challenged by more allegations that responsibility went further up the chain of command.

On May 19th, Jeremy Sivits pleaded guilty at his court martial and became the first American soldier to be imprisoned for his involvement in the scandal. The military policeman had earlier told investigators the abuse would not have happened had senior officers been present—thus supporting the administration's claim that a unit had gone awry.

Yet even as Mr Sivits's trial was going on, accusations were growing that senior members of the administration and military officers had set up a new interrogation system that led, indirectly, to the torture. According to Seymour Hersh in the *New Yorker*, Mr Rumsfeld authorised a secret programme after September 11th to kill or capture and interrogate “high value targets” in the war on terror. The programme, says Mr Hersh, was approved by every agency and the president was “informed” about it.

An article in *Newsweek* describes a Justice Department memo in late 2001 permitting the CIA to use sleep deprivation and other “stress factors”; it also reports on a memo from the White House counsel, Alberto Gonzales, calling the Geneva convention's rules on interrogating prisoners “quaint”. All this happened before the Iraq war. The harsher interrogation techniques were aimed at terrorists taken in Afghanistan; but when the methods proved successful, they were apparently transferred to Iraq.

According to the official report by Major-General Anthony Taguba, the commander of detention at Guantánamo Bay, Major-General Geoffrey Miller, was sent to review interrogation procedures and recommended that the Iraqi prisons be put at the service of military-intelligence needs. A new report in the *New York Times* says that, according to the officer in charge of interrogations at Abu Ghraib, intelligence officers ordered prisoners to be stripped naked and shackled before interrogation.

The accounts come from multiple sources, which adds to their credibility. If they are indeed true, three points emerge. First, harsher interrogation techniques were permitted after September 11th with al-Qaeda in mind; second, these methods were copied in Iraq, even though few of the prisoners there are al-Qaeda members; third, a chain of command was evident. Meanwhile, Mr Bush's approval ratings continue to slide, as more gruesome pictures from the jail appear, and even Republicans worry what his strategy in Iraq is. Mr Rumsfeld is not off the hook yet.

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Swing states

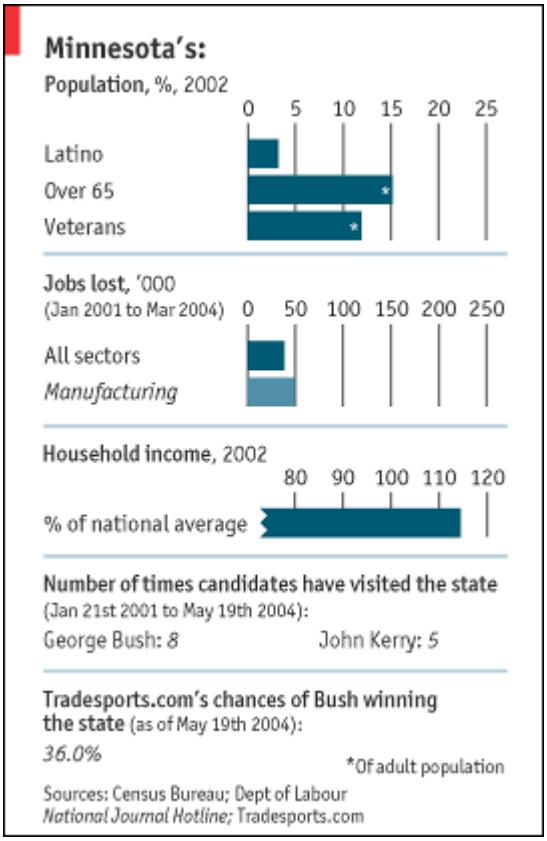
Too southern for Minnesota

May 20th 2004 | BLAINE, MINNEAPOLIS AND WILLMAR
From The Economist print edition

The third in our series looks at a state where demography is moving in George Bush's favour, but the Iraq war is deeply unpopular—as are Dixie values

IT IS a sunny day in Blaine, but you would not know it inside the sprawling sports centre. Shivering around four Olympic-size ice rinks, ranks of middle-class parents wearily watch their children play ice hockey. Voters like these, from the suburbs of the Twin Cities of Minneapolis-St Paul, will decide how the state votes in the presidential election in November.

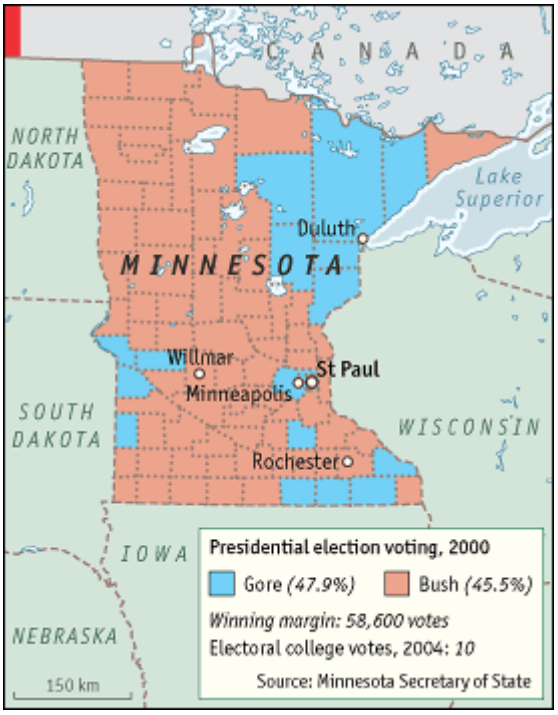
It is a measure of how much Minnesota has changed that George Bush is within shouting distance of success. The state of Hubert Humphrey, Walter Mondale and the Democratic-Farm-Labour (DFL) Party once held almost mythical status among liberals. They saw it as a sort of Nordic paradise, full of pristine lakes and forests, generous social programmes, thriving culture and blue-eyed blondes with a Scandinavian penchant for worthy causes.



Nowadays, Minnesota's congressional delegation is split evenly between the DFL, as the local Democrats like to be known, and the (fairly moderate) Republicans. It has not elected a Democratic governor since the 1980s. In 2002, when Paul Wellstone, the most left-wing member of the Senate, was killed in a plane crash, his seat was won by the Republican mayor of St Paul, Norm Coleman.

Demography is on the Republicans' side. The DFL coalition between farms and labour has frayed, as people have moved away from agriculture in the south and the iron mines in the north-east—and into the suburbs. There they have often discovered that they have less in common with cosmopolitan liberals than they imagined. Meanwhile, outsiders have poured into the same suburbs, seeking a comfortable place to bring up their families; many of them are more interested in low taxes than in generous welfare programmes.

Four of the counties gathered around the Twin Cities now have half the state's population. Blaine, once full of grassland farms and trailer parks, bustles with new housing developments and shopping centres. It has a biggish golf tournament and hopes for both a professional-sports stadium and a light-rail extension. The population of Anoka County, where Blaine sits, has jumped from 196,000 in 1980 to 310,000 today.



Once a Democratic stronghold, Anoka County became the heart of “Ventura country”: it rallied to Jesse Ventura, the wrestler who became governor in 1998 on a Reform (later to be Independence) Party ticket that offered low taxes and social tolerance. In 2002, Tim Pawlenty, the current Republican governor, captured 30 of the 38 counties that Mr Ventura won. Having signed a pledge not to raise taxes, Mr Pawlenty has kept a lid on social services.

It may be that Minnesota is becoming more like the rest of America. Conservatives used to joke that it really belonged to Canada; but it now has only the tenth-heaviest tax burden in the country. Libraries and park services have been cut, and visa-expiry dates are now stamped on the driving licences of immigrants in a most unScandinavian way.

Mr Bush is certainly on the prowl in Minnesota. He has visited the state eight times since taking office, and his organisation is in high gear, while John Kerry's is still at the stage of buying office furniture. Despite this, the most recent poll, in late March, gave Mr Kerry a 12-point lead.

The economy provides one grudge against Mr Bush—though a smaller one than in other mid-western states, because Minnesota's more diversified economy has held up relatively well. Plenty of suburbanites have felt the squeeze, but the economic hurt seems concentrated in the north-eastern “Iron Range” (“Talk about steel imports and it really gets them going,” says Tim Penny, a former Independence Party candidate for governor), and in rural areas. In Willmar, a town in central Minnesota, the local Jennie-O meat-processing plant has hired waves of immigrants, but growth has slowed. At Bihi's Shop of African Foods, a dozen Somalis say they like their new home, but moan that jobs are harder to find now. The two of them who can vote will go for Mr Kerry.

A bigger problem for Mr Bush is the Iraq war. There is something of an urban-rural split on the issue—with the plains far more inclined to back the president and the troops, who tend to come from rural areas. Yet Mr Bush's belligerent approach seems to have touched a peacenik nerve in the state. Lawrence Jacobs, a political scientist at the University of Minnesota, points out that the president's ratings on terrorism are about ten points lower in Minnesota than they are nationally.

This ties into a broader suspicion that Mr Bush's brand of Republicanism is just a little too Dixified for Minnesota. Ventura country likes Schwarzenegger Republicans, pragmatic figures who take a moderate stance on social issues such as abortion and the environment. Minnesota has relatively high church-attendance rates, but the evangelical influence is still much fainter than in, say, Texas; Minnesota Christians, with their Lutheran cast, devote their energy to social justice in the third world rather than dreaming up new ways to punish the wicked at home.

One small opening for Mr Bush could be provided by Ralph Nader, the independent. Last time, when Mr Nader ran as a Green Party candidate, he won 5% of the vote in Minnesota. Many Wellstone supporters despise Mr Kerry's moderation on Iraq (where only Mr Nader seems keen to leave immediately). On the other hand, their dislike of Mr Kerry pales beside their longing to remove Mr Bush.

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Lexington

It's a gas

May 20th 2004
From The Economist print edition

The politics of oil prices and Joe Sixcylinder may be changing

THE president's job-approval ratings hover around 40%. He is embroiled in a seemingly intractable crisis in the Gulf. American lives are at stake. At home, he faces record-high petrol prices just as the summer holiday season is about to begin. Inflation is stirring, and the Federal Reserve will soon raise interest rates.

No, not George Bush, though those descriptions apply to him, too. This was the situation facing Jimmy Carter in the summer of 1980 as he entered the election battle that he lost to Ronald Reagan. Of all the parallels, perhaps the most intriguing concerns the price of petrol (or gasoline).

Petrol prices could be the great sleeper issue of this election. Iraq and jobs may dominate the headlines; but the moment when many voters feel really angry with the administration is when they stand in the gas-station and see the dial has reached $2 a gallon (3.8 litres). The national average passed that mark this week. In early April, the Pew Research Centre discovered that more Americans were tracking news about the price of petrol “very closely” than were following either the story of the four Americans dismembered in Fallujah or the attacks on Mr Bush by his former counter-terrorism official, Richard Clarke.

Naturally, the Democrats cannot resist striking a match and tossing it hopefully towards the slick. This week, John Kerry criticised the president for cosying up to the Saudis without results. Some congressional Democrats want the administration to drive down prices by releasing 60m barrels from America's strategic petroleum reserve; many more, including Mr Kerry, want the government at least to stop adding to the reserve, as it has been doing since September 2001. Both demands have been turned down—for now. But next weekend includes the Memorial Day holiday, the traditional start of summer, when people climb into their gas-guzzlers to drive to the wild blue yonder.

To most Europeans, the political significance of petrol prices is fairly mild. But then most Europeans do not live, eat and sleep in their cars. And because European taxes account for so much of the price of petrol, although that price is high ($5.50 a gallon in Britain now) it changes less. There are still revolts—the British went crazy when their government tried to jack up fuel taxes in 2000—but the price of petrol does not have the same visceral effect as it seems to have on the American forecourt.

That said, the politics of petrol prices in America has clearly changed since 1980. That is partly because

petrol is much cheaper than it was 25 years ago. Translated into current dollars, the pump price in the summer of 1980 would be nearly $3 a gallon. In 1980, there was rationing, with drivers queuing for hours or able to fill up their cars only every alternate Wednesday (something that struck many voters as unAmerican). More broadly, in 1980 high petrol prices seemed to prove a profound economic malaise. The traditional “misery index” (inflation plus joblessness) peaked at 21. America was going to the dogs and was about to be bought by Japan. Now, the misery index stands at about eight, and, even allowing for matters like the budget deficit, the economy is in reasonably good shape.

Perhaps the biggest difference between the 1980s and now, though, concerns the main political liabilities of the two presidents. Mr Carter was seen as weak and ineffectual. He failed to prevent hostages being taken in Iran. The rescue mission he dispatched just before the election crash-landed in the desert. High petrol prices were just another misery he had been unable to forestall. They brought home to car owners the president's inability to cope. His were sins of omission.

Mr Bush's job approval is Carteresque—his overall approval rating has just hit 42%, the lowest of his presidency and only just above Mr Carter's 38% at this stage. But Mr Bush is being hurt by sins of commission. The occupation of Iraq is the product of action—Saddam's overthrow—not inaction. The soaring budget deficit is the result of decisive measures to cut taxes. No one could call Mr Bush weak and ineffectual. At the extremes of politics, there are plenty of accusations that high oil prices are all part of Mr Bush's canny plot to reward his friends in the oil business; but then these tend to come from the same sort of conspiracy theorists who said Iraq was invaded only for cheap oil.

From a political viewpoint, Mr Bush seems to be doing the right thing. Talking about energy crises (however fictitious) and shoring up the oil reserves (however pointlessly) may make no economic sense. But they give the impression to Americans that their president is doing something. Like the Democrats, he is going through the motions.

Towards a non-oil future

Indeed, when people look back on the current rumpus, they may muse most on the way oil has declined as a political issue. In election years gone by, “$2-a-gallon gas” would have been a landscape-changing issue; now it is somewhat closer to a consumer annoyance. Oil's importance to America is receding. America uses roughly half as much oil in relation to the size of its economy than it did in 1980—though that is still a lot.

If oil really is losing its place as a neuralgic point of American politics, that could change two longstanding nostrums in the capital. First, that the House of Saud should be treated with far greater consideration than you might expect for a country that exports its form of fundamentalism throughout the Muslim world; and second, that a carbon tax—every sane economist's answer to America's rotten environmental record—would prompt an insurmountable consumer backlash. The somewhat manufactured quality of this year's political tantrum over oil may presage big changes to come. But first Joe Sixcylinder's phlegm has to be proved; and as he stares at that $2 price next weekend, whilst the sun blares down, the dial clicks up and the kids scream in the back of the car, he may be sorely tested.

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Central America

Bringing it all back home

May 20th 2004 | SAN PEDRO SULA AND MANAGUA
From The Economist print edition

AP

A prison holocaust reveals the scale of the gang culture carried home by Central Americans returning from the United States

THERE was one distinguishing feature common to many of the 103 charred bodies of the victims of a fire that swept through a wing of an overcrowded prison in San Pedro Sula, in northern Honduras, on May 17th. Most of the bodies were heavily tattooed. The dead were all members of youth gangs, most imprisoned for the mere act of belonging.

Youth gangs and the crime and violence they engender have become one of the most serious problems facing the five small and mainly poor countries of Central America. The prison at San Pedro Sula, Honduras's second city, was designed to hold 800 inmates but was crammed with 2,200. That is partly because President Ricardo Maduro's government, like several of its neighbours, is trying to crack down on the gangs. Last August, it amended the penal code to make mere membership of a gang a criminal offence. El Salvador has done the same; Nicaragua is poised to follow. In Honduras, the police were ordered to haul youngsters off the street and straight to prison just for having the distinctive gang tattoos. Since August, more than 1,000 have been jailed.

Many Hondurans applaud this tough stance. But the fire shows the fatal weakness of the policy. Though its cause may have been an electrical fault, survivors claimed that prison warders added to the death toll by refusing to open cells for up to two hours after it started. A year ago, 68 prisoners, most of them gang members, were killed during a riot at another Honduran prison; many were shot by guards.

Critics argue that governments should look at what lies behind the rise of the gangs rather than criminalise them. The gangs' origins lie in the wars that engulfed Central America in the 1970s and 1980s. To escape these, many Central Americans migrated to the United States, and particularly to Los Angeles. Their children imitated that city's gang culture. In 1992, as the wars were dying down, the United States decided to start deporting jailed gang members when their sentences were over.

The notorious Salvatrucha

Back in countries that were almost foreign to them, with no jobs, the deportees set up their own gangs. According to government estimates, 36,000 people are said to belong to gangs in Honduras, 14,000 in Guatemala, 10,500 in El Salvador, 1,100 in Nicaragua and 2,600 in Costa Rica. The true figure is almost

certainly much higher. The most notorious of hundreds of gangs, or *maras*, is the Mara Salvatrucha, named for its Salvadorean founders who claimed to be as wise as a trout. Its initials appear in graffiti across the region. Many of the prison dead were MS members.

To see why young men—and women—flock to the gangs, just go to one of the poorer neighbourhoods of a city such as Managua, Nicaragua's capital. Each barrio has its own gang. In Ilario Sánchez, for example, one youth in three belongs to El Cartel, the local gang, according to “Jean Paul”, one of its members (who says he takes his *nom de guerre* from a rap singer). Most have their own weapons, usually machetes; some even make their own pistols. With jobs scarce, he argues that there is little else to do than join a gang. Crime becomes the only route to respect, power and money. Some of the money goes on drugs, which are dealt and consumed openly on the streets.

Most of the gangs, like El Cartel, are strictly local affairs. They engage in petty crime and low-grade extortion of local shopkeepers. It is the bigger gangs, such as the Mara Salvatrucha, that have governments worried. The MS spans Central America, Mexico and the United States; its leaders probably still live in Los Angeles, and it even has adherents in places like the Virginia suburbs of Washington, DC. In southern Mexico, it has killed scores of Central American migrants trying to reach the United States, often for nothing more than a pair of trainers.

The MS lacks the rigid hierarchy and deep pockets of the Italian Mafia. But there is evidence that its graduates are running kidnap gangs in places like San Pedro Sula, which prey on foreign businessmen. It is this move from street-fighting to organised crime that has prompted governments to crack down. Armando Calidonio, Honduras's deputy minister of public security, argues that his government's hard line, which includes a stiff gun-control law, is working. Kidnapping and bank robberies fell last year, but murders increased.

Some commentators question whether crime is in fact falling. They criticise a policy that lumps together hardened gangsters and naïve teenagers who might acquire a tattoo just to impress a girlfriend. Once in prison, the two merge. In San Pedro Sula's jail, the staff had little control over the gangs, according to Wim Savenije of Flacso, a graduate school in San Salvador, who has visited it. He argues that better enforcement of existing penal codes and community policing are preferable to draconian new codes which provide short-term relief but worsen the underlying problem.

Others argue for investment in rehabilitation schemes and sports facilities to keep young men occupied. In one such scheme, El Cartel and other gangs from Managua's barrios will compete this weekend in a football tournament organised by the city council. At least they will be kicking a ball rather than each other's heads.

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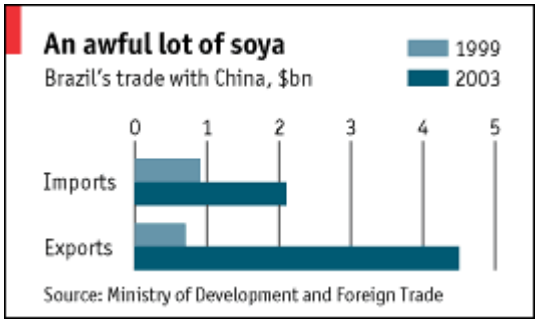
Brazil and China

Hot flush

May 20th 2004 | SÃO PAULO
From The Economist print edition

Lula visits a new "thought partner"



CHINA fever is a worldwide syndrome but Brazil has an especially acute case. Since 2000, trade between the two countries has leapt nearly threefold (see chart), making China Brazil's fourth-largest market. This has been a blessing for an indebted economy and especially for its producers of soya beans, iron ore and steel, which account for two-thirds of the goods exported.

Luiz Inácio Lula da Silva, Brazil's president, has caught the bug too. Next week he intends to pay his first presidential visit to China, with several hundred businessmen in tow. He speaks rhapsodically of "affinities of thought" between the two third-world giants on such issues as global trade talks and the United Nations, and of the need to create a "new geography of world trade". Eventually, he hopes for a bilateral free-trade accord.

With hopes so high, there is bound to be some disappointment. China is trying to cool down its overheated economy, and this could dampen Brazil's export growth. Its voracious appetite for commodities and Brazil's mighty capacity to supply them make the two economies look complementary. But attempts to broaden that relationship will turn up areas of competition as well. Lula is right to court China, but would be wrong to expect a friction-free partnership.

Commodity prices, though still high, have fallen from their peaks on speculation that China's growth will slow from its current annual pace of nearly 10%. But a slowdown in China should not be a serious worry for Brazil. HSBC, a British bank, calculates that if exports to China and commodity prices had both remained at 2002 levels, Brazil's trade surplus would have been $19 billion last year rather than $25 billion—a tangible but not drastic difference. A further fall in commodity prices would have compensating benefits for Brazil: it would reduce inflationary pressure, allowing interest rates to fall, points out ABN-Amro, a Dutch bank.

According to Kenneth Geld of Louis Dreyfus, a French agribusiness house, "even if China only grows 6% a year, the megatrend is rural migration to cities and changes of diet, so demand [for soya] will continue to expand." And the only countries that can meet it, he says, are Brazil and Argentina.

To secure the flow of commodities and remove obstacles that push up the cost of shipping them, officials are expected to sign an agreement under which Chinese investment in Brazil's railways and ports would be financed by commodity exports. There is talk of Chinese investment in schemes to link Brazil to the Pacific Ocean through Peru or Chile, which could reduce transport time to Asia by a fortnight.

Whether many manufactures will join commodities on the road to China is not so clear. Embraer, an aircraft-maker, sells jets in China but they are assembled there by a joint-venture. Marcopolo, which makes bus bodies, is studying whether to set up a factory in China. Costs are lower there, says Carlos Zignani, a manager at the firm, and the market is "a little closed."

Many Brazilian producers would like a little protection from China, notwithstanding Lula's proposal for free trade. Textiles, for example, should be exempt from a tariff-reduction agreement, pleads Domingos Mosca of Brazil's textile-industry association. Taken too far, China fever could make some Brazilians sweat.

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Canada

Ice brawl

May 20th 2004 | TORONTO
From The Economist print edition

A new beverage prompts a battle

CANADIANS are adept at extracting advantage from their long, hard winters. Two decades ago, a couple of Canadian vineyards began producing ice wine, a German invention in which frost-bitten grapes are left on the vine until temperatures drop to as low as minus 13 degrees Celsius. Their high sugar content produces a complex—and expensive—dessert wine of which Canada has become the world's leading producer.

Now ice wine faces an upstart rival—ice cider, or “apple ice wine” as some of its boosters like to call it. A dozen apple growers and vintners in Quebec have started producing this amber potion. It is made from apples that are pressed into juice and then placed outdoors in large vats in freezing temperatures. The water crystallises, leaving a thick, sweet syrup. After months of fermentation, this produces a beverage with 12% alcohol, similar to wine. It sells for about C$20 ($14.40) for a small bottle, or half the price of ice wine.

Quebec's government-run liquor stores (known as SAQ) sold C$3.1m of the stuff last year, double the figure of the year before. Some has found its way to Europe and Asia. One enterprising producer, François Pouliot, is selling ice cider to Galeries Lafayette in Paris.

But not everyone is celebrating. “If they try to pass it off as ice wine, that I wouldn't tolerate. We've put 20 years into getting our standards straight,” sniffs Donald Ziraldo of Inniskillin Wines, an ice-wine pioneer. Those standards include a national appellation. This paved the way for an agreement signed last September allowing Canadian ice wine to be sold in the European Union.

Ice cider, by contrast, is a free-for-all. That may seem a virtue—Canada's drinks industry is still subject to the quaint notion that only the government is qualified to sell booze. But a few rules would help in marketing ice cider, to distinguish it from headache-inducing grog. “The producers have to define how ice cider is made. Until then, they won't have regulations,” says Louise Riopel of SAQ. So the SAQ ordered Mr Pouliot to remove a “seal of authenticity” from his bottles.

Another producer, Guy Tardif, will present his Pommes de Glace ice cider at Turin's Salone del Gusto, a gastronomic fair, this autumn. Perhaps the frozen orchards of Quebec have indeed found a promising new niche product. After all, across the Atlantic, Calvados flourishes in the shadow of Cognac.

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Colombia's paramilitaries

Bandits or politicians?

May 20th 2004 | BOGOTá
From The Economist print edition

An eyebrow-raising deal

Get article background

FOR the past ten months, President Álvaro Uribe's government has held talks about peace with leaders of the brutal right-wing vigilante militias known in Colombia as the paramilitaries. Yet apart from a showy demobilisation by a few hundred vigilantes in Medellín in November, little progress had been made. Despite a supposed unilateral ceasefire, the paramilitaries carried on killing and, in places, the army engaged them. Recently, the talks had seemed close to breaking down.

So it was a surprise when last week ten leaders of the paramilitaries, who are grouped in the United Self-Defence Forces of Colombia (AUC), reached an agreement with the government. This will see them and their personal bodyguards—some 400 fighters in all—gather in a “location zone” in Córdoba, in northern Colombia, where talks will continue. In return, the government has agreed to lift arrest warrants against the ten, who include Salvatore Mancuso, the AUC's military leader. Many of the ten are wanted for drug-trafficking as well as murder. The United States wants to extradite Mr Mancuso and one of the others to face drugs charges.

Between them, the ten represent 90% of the AUC, an organisation which the government says is 20,000-strong, though it is riven with regional rivalries. Yet the appearance of progress may be deceptive. The accord comes after the disappearance last month of Carlos Castaño, the AUC's founder and best-known leader. Mr Castaño had been pushing hard for a deal: he was said to be prepared to plea-bargain with the United States, and to accept that AUC leaders would have to serve some jail time. For this, he is believed to have been murdered by his AUC colleagues.

With Mr Castaño gone, some see the AUC as little more than a drug network, albeit a heavily armed one. “The mask has slipped,” William Wood, the American ambassador in Bogotá, told *Semana*, a weekly magazine.

So why the deal? Cynics, such as Rodrigo Franco, a dissident paramilitary leader from Medellín, reckon that the ten have extracted a government promise not to extradite them. Officials insist that is not so. Mr

Uribe has accused the AUC of plotting to kill him. Yet the government's position seems ambivalent. “Extradition is not a matter for negotiation. Those who wish to avoid it must show to the international community their good faith and their intention to reform,” it stated recently. A well-placed source in Washington, DC, says that Mr Uribe suggested during a recent visit to the State Department that it drop extradition warrants in order to smooth the peace talks. But the Bush administration insists extradition is not negotiable; Mr Castaño's disappearance makes a change in this policy less likely.

The government claims that the “location zone” in Córdoba, long an AUC stronghold, is not a repeat of the enclave granted by Mr Uribe's predecessor to their foes, the FARC guerrillas, during failed peace talks. It is much smaller and is supposed to be more closely supervised, by the Organisation of American States; the army will continue to patrol the area.

Yet many obstacles lie ahead. Luis Carlos Restrepo, the government peace negotiator, says Colombia will need up to $150m in foreign aid to demobilise the AUC. The biggest issue is what punishment, if any, AUC leaders will receive for their massacres of civilians as well as for drug-trafficking. Mr Uribe has withdrawn an initial proposal that would have allowed them to get away with merely paying “compensation” to their victims. His latest plan involves them being “confined” (not necessarily in prison) for five to ten years, but does not link their privileges to continued demobilisation and full disclosure of assets, many of which come from drugs.

That will not satisfy human-rights groups abroad nor, probably, the Bush administration. But it may be too much for the AUC, as Alfredo Rangel, a defence analyst in Bogotá points out. He sees difficulties in persuading all of the AUC's factions to sign up to any agreement, and in verifying their behaviour. As one paramilitary put it: “We haven't fought for 20 years in order to be shown out by the back door.”

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Guyana

Policing the cops

May 20th 2004 | PORT-OF-SPAIN
From The Economist print edition

Politics and a death squad

Get article background

RECENTLY, Guyana's government has been under pressure to do something about reports of a death squad and claims that gun licences and telephone records link this to the home-affairs minister, Ronald Gajraj. The United States and Canada have each revoked Mr Gajraj's visa, though without stating their reasons. The opposition and human-rights groups want a commission of inquiry.

On May 14th, Guyana's president, Bharrat Jagdeo, finally announced one, to be chaired by an appeal-court judge. But the leader of the main opposition party, Robert Corbin, retorted that he would not co-operate with the inquiry, nor accept its findings. He questioned its membership and terms of reference.

Guyana seems to be heading the same way as Jamaica. In a country with just 750,000 people there have been 335 murders since a mass jailbreak in February 2002; the victims included 24 police and 67 people killed by the police or army. The police sometimes kill innocent bystanders, but they must also tackle powerful cocaine gangs.

Unlike Jamaica, Guyana is racially polarised. Many Indo-Guyanese, who vote for the governing party, feel picked on by Afro-Guyanese criminals, and neglected by the mainly Afro-Guyanese police. Most Afro-Guyanese support the opposition; many feel the police are manipulated by the government.

Government and opposition agreed last year to a “constructive engagement”. But Mr Corbin broke this off last month over the death squad allegations. He is now boycotting parliament. The next election, two years off, is already casting a shadow. An inquiry—if it proceeds—may not suffice to lift it.

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India's new government

Sonia: and yet so far

May 20th 2004 | DELHI
From The Economist print edition

AP

Formed in a shambles, India's new government can only get better

Get article background

THE comparisons that have been drawn with the Buddha and Mohandas Gandhi seem a bit overblown. But India reveres renunciation, and the decision by Sonia Gandhi (no relation to the Mahatma) to forgo the chance to become India's prime minister has mightily enhanced her stature. It has probably also been good for her party, Congress, and the prospects of the government it will lead under Manmohan Singh, her anointee, who was due to be sworn in on May 22nd.

The party itself found this hard to accept. Its members of parliament seemed to think they had wandered into a production of “King Lear”, a less happy tale of renunciation. In an emotional—nay, hysterical—meeting on May 18th they hectored, cajoled and begged Mrs Gandhi to change her mind and take the job. The unbridled sycophancy was a reminder of the party's feudal attachment to the Nehru-Gandhi dynasty, and fear that, without her as a neutral figurehead, its kingdom will fall apart.

Mrs Gandhi was swayed neither by them nor by the several hundred equally high-pitched party activists gathered outside her front gate, some of whom felt genuinely cheated. They had worked hard to help her achieve the election result announced on May 13th, bringing a Congress-led coalition back to power against all expectations. They had rooted for her right to be prime minister despite being born in Italy. Some argued, incredibly, that if she was unwilling to serve, then her son Rahul, a 33-year-old first-time MP, should step in. Others complained she was yielding to a xenophobic campaign that should have been confronted.

That may indeed have been one factor in Mrs Gandhi's decision. The Bharatiya Janata Party (BJP), the former ruling party, and its coalition partners had said they would boycott her swearing-in, though the BJP's leader and former prime minister, Atal Behari Vajpayee, would attend. One former BJP government minister, Sushma Swaraj, and her husband were to resign their seats in the upper house of parliament in protest at the “national shame” of installing an Italian-born prime minister. Similarly, another senior BJP leader, Uma Bharti, had resigned as chief minister of the state of Madhya Pradesh. After Mrs Gandhi's sacrifice though, Miss Bharti, a *sanyasin*, or religious renunciate, looked rather silly.

Other groups linked to the Rashtriya Swayamsevak Sangh (RSS), the Hindu-nationalist mass organisation that spawned the BJP, had already taken this campaign to the streets. Ram Madhav, an RSS spokesman, blamed the BJP's electoral defeat in part on its failure to find “any real national-level emotive

or ideological issue". There was a risk that Mrs Gandhi's Italian origins might fill that void and prove the dominant theme of the new government's early days. Rahul Gandhi and his sister Priyanka were also said to oppose their mother's taking office, fearing for her life, though Rahul denied this. Their father, Mrs Gandhi's husband Rajiv, and grandmother, Indira, both former prime ministers, were each assassinated.

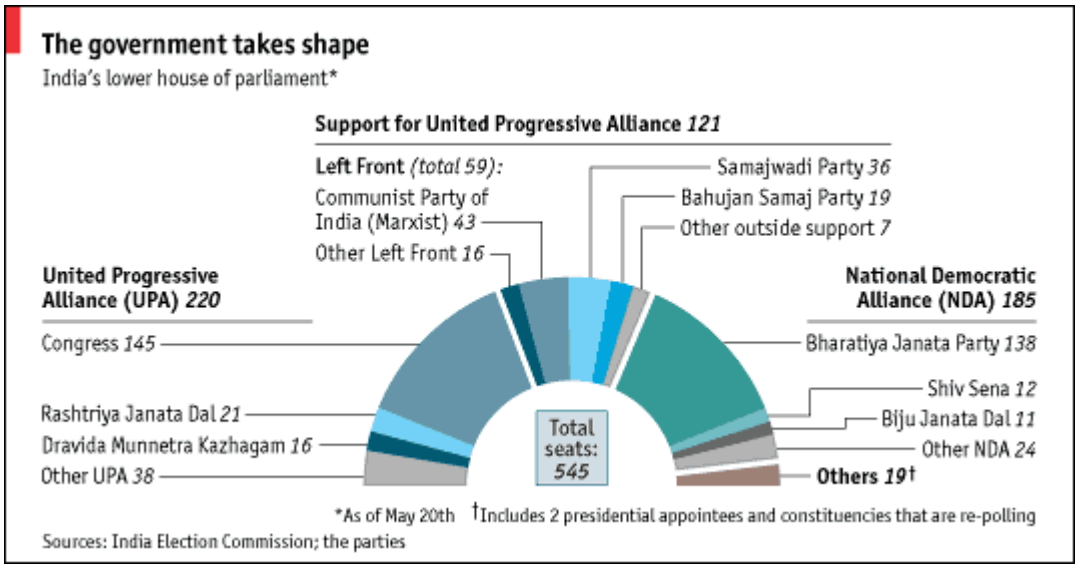
Mr Madhav claims that even some Congress voters were uneasy about being ruled by a native Italian, and he probably has a point. She speaks Hindi, wears sarees and says she prefers *naan* to pasta. But her foreign birth would always have been a stick to beat her with. Her party's mandate in the election was hardly a clear-cut endorsement either of its policies or its leader. Congress gained just under 27% of the national vote, about 1.5 percentage points less than in the last election in 1999. Its coalition won almost exactly the same share of the votes, about 36%, as the BJP's.

Mrs Gandhi herself had always been careful not to promote herself as a prime-ministerial candidate. During the campaign, this was seen as a shrewd tactic to stop the BJP turning it into a presidential-style contest between an untested, foreign-born novice and the popular, statesmanlike Mr Vajpayee. It now seems that Mrs Gandhi all along saw her duty as limited to rescuing her late husband's party from its recent slump and, in her words, to providing India with "a secular government that is strong and stable"; but not leading it.

Outside the Congress hot-house, some were relieved at that. The political drama in Delhi was played out against the distant thud of a crashing stockmarket. The Mumbai exchange suffered its worst-ever day on May 17th, at one point having fallen by more than 17%. The next day, news that Mrs Gandhi was thinking of stepping aside helped spur a recovery.

One reason for the market's cheer was the assumed identity of Mrs Gandhi's replacement. Having attributed to her the wisdom of the Buddha it was inevitable that Mrs Gandhi's parliamentary colleagues would ask her to nominate one. Her choice, Manmohan Singh, is popular with investors as the author of India's economic liberalisation. An academic economist, he was Congress's finance minister in 1991, when, in response to a balance-of-payments crisis, the government launched a package of reforms, beginning the dismantling of the "licence raj" of state planning, import controls and excessive regulation that was Nehru's legacy.

So his presence is heartening for investors who have two worries about the new government: first, that it will be hostile to business and reluctant to continue or accelerate the liberalisation Mr Singh began; second, that it will be unstable and short-lived. The fears stem partly from its status as a minority government. Not only will Congress rely on a coalition—to be known as the United Progressive Alliance (UPA)—but the UPA will itself be a minority (see chart), relying on the "outside support" of other parties, of which much the biggest is a "Left Front" dominated by the Communist Party of India (Marxist), or CPI (M).



Playing the red card

The CPI (M) has been in power in the state of West Bengal since 1977, and like ruling communist parties

elsewhere, has become pragmatic in office. Once notorious for red tape and strikes, the state has recently been hard-selling its attractions as a destination for inward investment in information technology and services such as call-centres. The Communist chief minister, Buddhadeb Bhattacharjee, boasts of its success in promoting enterprise: exporting roses to the Netherlands, and housing potato-processing facilities for PepsiCo. It has even, with the help of British government aid, been closing down some of its loss-making state enterprises.

But during the election, Mr Bhattacharjee said that the CPI (M) could never join a Congress-led coalition, because of differences on economic policy. Mr Singh, whom the Communists are now happy to accept as a prime minister, was “the first torch-bearer for the IMF”. One cause of the stockmarket crash was a suggestion by a Communist spokesman that the disinvestment ministry, which oversees India's privatisation programme, should be abolished (not a bad idea in itself, but he appeared to want to abolish privatisation as well).

The possibility of an end to the “disinvestment” of state enterprises, which in recent months helped fuel a surging stockmarket, is a specific fear of investors. A broader concern is that all economic policy will likewise be hostage to the populist demands of Congress's coalition partners. A number of the reforms that economists argue are most needed will probably not make much headway. Labour laws, for example, which make it hard to shed staff without state-government permission, are unlikely to be tackled.

The same is true of the reform that Arun Shourie, the outgoing BJP disinvestment minister, believed the most important of all, to the system by which funds are allocated to government departments and states. He argued that these reward poor performance—“the bigger the deficit, the bigger the grant”. But tampering with this system may not appeal to state leaders whose support Congress needs, such as Laloo Prasad Yadav of Bihar, a state notorious for economic underperformance.

One reason for the market's cheer was the assumed identity of Mrs Gandhi's replacement

However, fears that reforms are about to be shelved, and the markets' reaction, seem excessive. The reform process has always involved more stops than starts, and Congress may be no worse placed to pursue it than was the BJP. Surjit Bhalla, of Oxus Fund Management, a hedge fund in Delhi, says that, since 1991, every government that has taken power in India has accelerated the reforms, and he expects this one to be no different. The Left, he says, is to Congress as the RSS was to the BJP, minus the RSS's communal tendencies. Just as the BJP had to resist the protectionist “self-reliant” economic tendency within the RSS, so Congress will be fending off leftist conservatism.

The markets are now awaiting the “common minimum programme” Congress and its partners are drafting. To the extent that this mirrors Congress's own manifesto, it will differ little from the BJP's approach, though privatisation is to be “more selective”, and not pursued, in Mr Singh's phrase, “as an ideology”.

The national vote was too evenly split, and too driven by local factors, to be interpreted as a clear mandate; much less, despite some attempts to do so, could it be seen as a national indictment of the reforms. But it has been taken as a slap in the face for the BJP from the mass of Indians who live in poverty in the countryside. Every new government pays them lip-service. This one, relishing the shock of victory, knows better than most how much it needs to concentrate on agriculture and rural infrastructure. That, however, is itself an argument for accelerated reform.

Stability pacts

The other fear about the new government is that it will prove shaky. Because it tends to be a competitor for power at the state level with its potential partners, Congress has in the past found it hard to forge national coalitions. Many UPA members have a price: one wants a new state carved out of Andhra Pradesh; another demands the ditching of harsh anti-terrorist legislation. Others, notably the Left parties and the Samajwadi (“Socialist”) Party, which won 36 seats in India's largest state, Uttar Pradesh, are not actually joining the coalition: a form of power without accountability. Not having the responsibility that goes with cabinet seats, they could blackmail the government on issue after issue, and risk turning policymaking into a saga of serial brinksmanship.

Power in Indian politics is a great adhesive. Having touched it, the Left will be loth to let it slip. But managing such a complex and potentially fissile arrangement will demand great political skill. Mr Singh

is, in this respect, untried. He is much admired as a kind, courteous and clever man. As a Sikh, he is India's first non-Hindu prime minister and living testimony to its secular traditions. But he sits in the upper house of parliament and has never won a direct election, though he will now have to do so in the next six months.

His first challenge will be to form a government that satisfies his coalition partners without sacrificing his policy goals. He is fortunate in being able to fill most jobs from Congress ranks. Besides the economic portfolios, much interest focuses on the foreign ministry and the post of national security adviser.

The next stage in the peace process with Pakistan—talks on measures to build confidence about the two countries' nuclear arsenals—is due next week. In August, foreign ministers are to meet, and by then the two sides should have begun to discuss the hardest issue, the status of Kashmir. Congress has supported the peace initiative Mr Vajpayee launched last year.

But it may find it harder to negotiate on Kashmir than would the BJP, whose Hindu-nationalist background makes it less vulnerable to attack from chauvinists. The peace process was to be Mr Vajpayee's claim to a place in history. It would be good if, in opposition, he ensured that it enjoys bipartisan support. But his party's willingness to stoke racist antipathy to Mrs Gandhi, and his own silence as it did so, do not bode well for restraint.

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Taiwan and China

Chen redux

May 20th 2004
From The Economist print edition

Inside the rhetoric, there are hints of a thaw all round

Get article background

Reuters

Chen: building bridges

RELATIONS between Taiwan and China are often so shrouded in fiery rhetoric, angry denunciations and disingenuous offers of reconciliation that it can be easy to miss any nuanced signs of compromise. Predictably, China unleashed a barrage of threats against Taiwan's President Chen Shui-bian just before he formally began his second term of office on May 20th. In his re-inauguration speech, Mr Chen said the European Union model suggested ways of approaching problems between Taiwan and China: an idea that China's current leaders would never endorse.

In a statement on May 17th, China warned that Taiwan's leaders would "meet their own destruction by playing with fire" if they kept pursuing their "separatist agenda". It said China would crush "firmly and thoroughly at any cost" any major step by Taiwan towards formal independence. Last week, during a visit to London, China's prime minister, Wen Jiabao, gave warning that unification was "more important than our lives".

China's aim was to ensure that Mr Chen did not use his speech to set out a pro-independence agenda. The Americans made it clear they shared China's concerns (although they criticised China's sabre-rattling). At present, although the island operates entirely independently, its constitution suggests it is part of a "Republic of China" including the mainland.

As expected, Mr Chen repeated his intention of producing "a new version" of the constitution by 2008. But here's where the subtleties come in. Mr Chen did not say the new constitution would be put to a referendum. China has warned that such a move would be a dangerous step towards independence, being tantamount to giving the people of one province the right to decide the future of the whole country. And Mr Chen said changes to the constitution would not touch on issues relating to Taiwan's sovereignty, territory or the question of independence. While heaping praise on the "fundamental changes" of thinking on sovereignty exemplified by the EU, he said Taiwan could understand why China still insisted on the notion of "one China", the island included.

Even China's pre-speech outburst contained hints of accommodation. It said that as long as Taiwan recognised that the mainland and the island were part of one China (it did not specify communist-ruled China), the two sides could work towards allowing Taiwan "international living space" and establishing military confidence building measures.

Mr Chen, who was re-elected by a mere 30,000-vote margin, said he would invite opposition parties to help draft guidelines for handling cross-strait relations. This is hardly likely to placate his political enemies at home. At the opposition's request, a recount of the 13m votes has been under way for the past few days. Few expect the eventual outcome—possibly still several weeks away—to result in Mr Chen's removal. China is likely to have to deal with a man whom it detests. But at least for now both it and Taiwan are shying away from outright confrontation.

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China's pensions

Time bomb

May 20th 2004 | BEIJING
From The Economist print edition

Evasive action needed

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THE pension system is a mess, and the government only has a few years to sort it out before a fast ageing population turns the problem into a full-blown crisis. Seven years ago, aware of the problem, China began trying to set up a new system. Unfortunately, it isn't working. There is rampant evasion of the exorbitant contributions required, and nearly half of urban employees are still not covered.

The idea was to change from a pay-as-you-go system, whereby retirees are paid out of the contributions made by those still working, to a partially-funded system. This would mean still providing a basic pension, but the retiree would also receive benefits from a “personal account” whose funds would be managed by social-security officials.

The problem is that the new pension system has taken on the liabilities of the old one. To pay retirees from the old system, local governments often use the money that should be going into the personal accounts. To make matters worse, farmers and migrant workers are almost entirely excluded.

According to the *21st Century Business Herald*, a state-owned newspaper, the funds accumulated in personal accounts should have amounted to around 480 billion yuan ($58 billion) by the end of 2002. But an official who deals with social security reckons there is probably only about 100 billion yuan in them. Out of 31 provincial governments, only six or seven have pension funds in the black, he says.

China also has a centrally administered social-security fund of around 130 billion yuan which is planning to invest more in equities. But this “fund of last resort”, financed mainly from government revenues, is still far too small to provide much reassurance. Shortsightedly, the central government has scaled back its contributions dramatically. In 2002, it gave the fund around 40 billion yuan. Last year it gave nothing. The fund's goal of amassing one trillion yuan in the coming five to ten years appears extremely ambitious.

An American think-tank, the Centre for Strategic and International Studies, said in a report published last month that the government should assume the burden of the old system's liabilities, transfer administration of the personal accounts to independent asset managers and allow investment of these funds in domestic and foreign capital markets.

There could be a political spin-off from such a move, the centre suggested. Funded pensions in the form of properly-managed personal accounts would give workers a stake in the success of economic reform, foster middle-class values and, over time, “may help transform China into a democratic society.” But the idea that China's economy will eventually be crippled if nothing is done may do more to goad the Communist Party into action.

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Japan

Politics by attrition

May 20th 2004 | TOKYO
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A pensions scandal threatens Junichiro Koizumi

HE SAYS he will not resign, but Junichiro Koizumi's government is now at risk. Mr Koizumi has admitted that during several periods before 1986 he failed to make payments into a national pension scheme. He had repeatedly denied it, even as other politicians—in every party—were exposed as non-payers. His chief cabinet secretary (Yasuo Fukuda) and the opposition leader (Naoto Kan) resigned after their own lapses came to light.

Mr Koizumi says that, unlike the others, he has done nothing illegal. He has paid consistently since 1986, when it became compulsory for lawmakers to do so. The opposition counters that this distinction comes too late: he had previously said only that his slate was clean. Mr Koizumi also, it appears, missed some payments in his twenties, when he was not exempt either. This dents his credibility as he tries to reform national pensions. Ichiro Ozawa put more pressure on him this week by declining to succeed Mr Kan as leader of the Democratic Party of Japan. Like the prime minister, all of Mr Ozawa's lapses occurred before payments became compulsory in 1986.

Mr Koizumi hopes that a trip to North Korea on May 22nd will boost support before July's upper-house elections. He will press the regime to release children born in captivity to Japanese citizens whom it previously abducted. But the scandal may hurt his Liberal Democratic Party badly. And the last time the party lost upper-house elections, in 1998, the prime minister resigned.

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South Korea

Four more years

May 20th 2004
From The Economist print edition

His impeachment overturned, Roh Moo-hyun gets back to work

Get article background

THEY exonerated him in impeachment hearings, but the Constitutional Court's nine judges still gave Roh Moo-hyun a stiff sentence: four more years as South Korea's president. Judging by Mr Roh's first year in office—during which he mishandled strikes and the media whilst fumbling about in general—that could be hard time indeed. His youngish supporters hope that his new, left-wing majority in parliament will help to turn his presidency around. To be safe, however, Mr Roh also reached out to mainstream South Koreans after the verdict, making a contrite televised speech on May 15th.

Although Mr Roh enjoys little public support, the outgoing parliament's decision to impeach him alienated voters. His only transgression had been to break a campaign rule by saying that he wanted the left-of-centre Uri party to do well in April's legislative elections. Mr Roh's accusers added charges of corruption and incompetence, arguing without much evidence that he was guilty by association with tainted aides. By tapping the resulting outrage, the Uri party tripled its seats in parliament and grabbed an outright majority. The Constitutional Court agreed—or went along—with the voters' verdict.

By impeaching Mr Roh, the opposition has thus transformed him from an embattled figurehead for frustrated leftists into the leader of a potentially dominant political party. His hard-core supporters, who resent both the economic influence of big business groups and the long-standing alliance with America, hope that he will seize the chance to steer policy sharply leftwards. For now, however, Mr Roh is reaching out to mainstream voters. This is partly a matter of style: in his post-impeachment speech, the normally stubborn and combative president apologised, took responsibility for his aides' misconduct and promised to listen to the opposition.

Mr Roh could also put moderate minds at ease by promoting economic stability and gradual reforms. Many investors applauded his appointment in February of a new finance minister, Lee Hun-jai. Economic growth fell by more than half last year, to 3.1%, as feeble domestic demand offset booming exports. The government hopes that private consumption will pick up as households recover from excessive credit-card debts.

Labour issues and foreign policy will remain dicey. Mr Roh's advisers would like a grand compromise on labour: businessmen would give more rights to temporary and part-time employees, and union workers would lose some of their cushy and costly protections. That will prove a tough sell, however, given the militancy of South Korea's trade unionists. So will any compromise between North Korea—which Mr Roh would like to placate—and the United States. If he stumbles, history's verdict will not be as kind as the judges'.

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Myanmar

A constitutional charade

May 20th 2004 | YANGON
From The Economist print edition

No junk food—and no democracy either

AP

Democracy in action

IN THE small town of Nyaung Hna Pin, 1,076 delegates gathered this week to draft a new constitution for Myanmar. The drafters, almost all of them hand-picked by the country's military junta, are sequestered in a conference centre surrounded by army bases. By law, they must not criticise or even discuss the proceedings with outsiders. The generals have helpfully laid out some guiding principles for the document, including a prominent role for themselves in politics. The delegates have even been told what to wear (national dress), what to eat (no junk food) and when to shower (not late at night). Local television has shown them nervously swiping at golf balls and singing quavering karaoke under the watchful gaze of the top brass.

Myanmar went through a similar charade once before, in the 1990s. After the National League for Democracy (NLD), the country's biggest pro-democracy movement, won a landslide victory in 1990, the junta cited the need to draft a new constitution as an excuse not to hand over power. A similarly rigged convention then agreed to all manner of repressive proposals such as reserving a quarter of seats in the national parliament and a third in regional ones for the army. The NLD eventually walked out. The junta then suspended the convention and reverted to its more familiar mode of ruling by diktat and locking up all of its critics.

This time around, the NLD has boycotted the proceedings from the outset, after the generals insisted that the new convention should pick up where the old one let off. They also refused to release Aung San Suu Kyi, the leader of the party and winner of the Nobel peace prize. Despite the NLD's absence, however, the junta may still meet some opposition at the convention. Representatives of various ethnic militias are attending, and have already registered their displeasure with some of the generals' ideas. These erstwhile rebels signed ceasefires with the government during the 1990s, but still enjoy some autonomy and retain all their weapons. The junta might find it hard to ignore their opinions, especially over the question of federalism. The previous convention collapsed not just because the NLD walked out, but also because various minority delegates began crying foul.

But most observers believe that the regime is determined to ride roughshod over all objections. It has produced a road map to democracy, which envisages a referendum on the constitution, followed by new elections. The government is already transforming its nationwide society of thuggish enforcers, the Union Solidarity and Development Association, into a political party, presumably with an eye to stealing any future elections. Many of its members are delegates to the convention.

U Lwin, the spokesman of the NLD, says that outsiders must put more pressure on the junta. But it is hard to imagine any country taking steps severe enough to influence Myanmar's isolationist rulers. The European Union and the United Nations have registered their dismay at the NLD's absence from the convention. Even Thaksin Shinawatra, Thailand's prime minister and a longstanding apologist for the generals, seemed astonished and dismayed by their failure to release Miss Suu Kyi. George Bush renewed American sanctions on Myanmar for another year on May 17th. But for the past 14 years, all attempts to persuade the regime to surrender power have come to naught.

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The Spratly Islands

Small is beautiful

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And valuable, for six suitors

IN THE Spratly Islands, tourism is war by other means. In March, Taiwan, one of six claimants to this disputed smattering of sandbars and reefs in the South China Sea, built a bird-watching hide on a pinprick previously frequented more by soldiers than ornithologists. In response, Vietnam dispatched a boatload of tourists on a cruise through the archipelago the following month. Now, it is refurbishing a former military airbase on Big Spratly, the largest of the specks it controls, to fly in camera-wielding reinforcements. Malaysia, for its part, is prone to unprovoked bouts of marine research in the area. China and the Philippines are quietly fuming.

All five countries maintain a military presence of some sort in the Spratlys (the sixth claimant, Brunei, is more retiring). In the fiercest of many clashes over the islands, in 1988, Chinese troops killed 70 Vietnamese sailors. As recently as 2002, Vietnam fired on a Philippine jet in the area. But later that year, all the claimants bar Taiwan signed an agreement to resolve their disputes by peaceful means. Hence the resort to all-out tourism.

The Spratlys lie amid rich fishing grounds and across the main shipping route from Europe to East Asia. They probably also sit atop valuable oilfields. If the row is not resolved by fighting, the degree to which different countries have exercised normal civil administration of the islands will become an important element of future legal claims. So, at least, the International Court of Justice implied when it awarded two nearby islands, Ligitan and Sipadan, to Malaysia last year over Indonesia's objections.

Vietnam, although not much of a democracy, now makes a point of conducting elections early and often in the Spratlys. It claims that 11 local councils operate on the islands. But there cannot be much for them to do: none of the islets reaches more than 15 feet above sea-level, and all of them put together cover less than five square miles (13sq km).

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Israel and Palestine

Can the dangerous vacuum in Gaza be peacefully filled?

May 20th 2004 | GAZA AND TEL AVIV
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EPA

Ariel Sharon wants Israel to evacuate the strip. But his party says no, and fighting has intensified

Get article background

THREE months ago Ariel Sharon, Israel's prime minister, said he would unilaterally “disengage” from the coastal Gaza strip, the lesser part of a would-be independent Palestinian state. But three weeks ago his own Likud party rejected his plan in a referendum. This week Israeli forces invaded Rafah, a town-cum-refugee camp that abuts Gaza's southern border with Egypt. This followed a ferocious bout of fighting last week that had left 30 Palestinians and 13 Israeli soldiers dead. It was the largest military incursion into Gaza for decades, and was condemned by the UN Security Council after America abstained. So far this week, at least 39 Palestinians, more than half of them civilians, were reported to have been killed and at least 1,000 have become refugees—all over again.

Israel says the aim of the attack is twofold: to destroy a warren of tunnels Palestinian guerrillas have long used to bring arms into Gaza, and to flush out Palestinian militias that have made the Israeli-controlled “Philadelphi route” along Gaza's border with Egypt the most lethal front-line in the Israeli-Palestinian conflict. Once these goals are accomplished, say the Israelis, their army will leave. It is not yet clear whether Israel intends to widen the Philadelphi route by bulldozing more Palestinian homes, and if so how many. Last week's fighting was accompanied by Israel's demolition of around 100 houses in Rafah. At the time, Israel's army chief of staff, Moshe Yaalon, said that “hundreds of houses” would have to be cleared if the border area was to be secured. Against a backdrop of American pressure and an international outcry, the Israelis seem to be holding back for now.

The Palestinians are taking no chances. Hundreds have already fled their homes in Rafah, bundling bedding and clothes on to wooden carts. For many, such scenes ominously recalled the mass flight of Palestinians, 56 years ago this month, when Israel was born and most of the Palestinians' homeland was lost. “It's the same thing,” said Hajar Amani, a Palestinian mother of seven who had her home destroyed by bulldozers last October and is now leaving a second, temporary one. “In 1948 they transferred us from our villages to the West Bank and Gaza. Now they're transferring us again.”

But there is nowhere to go. Rafah's 140,000 Palestinians are now sealed off from the south by the Egyptian border, to the west by the Mediterranean, to the east by Jewish settlements and to the north by a phalanx of Israeli tanks, helicopters and troops. Some 2,000 local people are squatting in tents or schools, swelling a population of 12,000 made homeless by earlier army incursions. “We are facing a humanitarian disaster,” says a UN official.

How does this square with Mr Sharon's disengagement plan? He has intimated that if the border near Rafah were more rigorously policed by Egypt and cleared of Palestinian militias, a more moderate “Palestinian partner” might emerge, though he has ruled out any dealing with Yasser Arafat. Mr Sharon says he has long looked in vain for an alternative, more malleable Palestinian leadership.

A report this week from Amnesty International claimed that many of Israel's actions were not only illegal but had failed, so far, to give it security. The human-rights group said that Israel had destroyed 3,000 Palestinian houses in the occupied territories in the past three-and-a-half years, including 1,000 in the Rafah area. In the name of flushing out Palestinian guerrillas, says Amnesty, Israel has razed 10% of Gaza's farmland in acts of “wanton destruction” with no military need.

Combined with Israel's decision since the beginning of the *intifada* to bar almost all Palestinians in the occupied territories from taking jobs in Israel, to minimise the risk of suicide attacks, such actions have reduced two-thirds of Gaza's 1.3m Palestinians to penury—and have destroyed the PA's authority. In Gaza the Palestinians' leadership has passed to Hamas, the Islamist resistance, which carries out many of the *intifada's* attacks.

After meetings this week with Colin Powell, the American secretary of state, and Condoleezza Rice, the national security adviser, the PA's prime minister, Ahmed Qurei, reluctantly endorsed Mr Sharon's disengagement plan provided it was a “first step to ending Israel's occupation of all of the occupied Palestinian territory”. He says he is ready to reform the PA's police to ensure a smooth Israeli withdrawal. But first he wants a “comprehensive ceasefire” under which the Palestinian militias stop fighting and Israel agrees to refrain from military onslaughts.

The European Union, the UN and Egypt are all quietly backing that idea. The Americans say that reform of the PA, and particularly of its security force, must come before a ceasefire. But Mr Sharon may well want his army first to be able to declare victory over the fighters in Gaza so that it does not appear to be leaving the strip in the manner it left southern Lebanon four years ago—under fire and with its tail between its legs. He says he wants to create a new “operational reality” in Gaza.

Politically, Mr Sharon has less room for manoeuvre than before. On May 15th, when his troops were pounding Palestinian houses in Gaza, some 150,000 Israelis were demonstrating in Tel Aviv's main square, calling on his government to withdraw from the Gaza strip—come what may. It was the biggest and boldest show of force by the Israeli left in almost a decade. For a change, its various factions agreed to a joint slogan: “Leave Gaza, start to talk”. Unusually, the opposition did not call on the government to go but united behind its embattled prime minister against his disaffected party and those in his cabinet still against withdrawal.

The left has offered to back Mr Sharon, not just in pushing ahead with his plan to withdraw from Gaza but also to help him seek a wider consensus among Israelis—something he had turned his back on since the failure of peace talks between Mr Arafat and the previous Israeli prime minister, Ehud Barak, at Camp David in 2000, which led to the Palestinians' current *intifada*. Opinion polls show that most Israelis, even Likud voters, want to leave Gaza, where there are some 7,500 Jewish settlers.

One reason for this is that Israelis are highly sensitive to military casualties. The death of 13 soldiers in last week's Gaza battles was treated as a national tragedy, reviving grim memories of the 18-year war around's Israel's self-declared “security zone” in Lebanon, which was meant to remove the threat of incursions from across Israel's northern border but extracted a heavy toll in soldiers' lives.

Despite his humiliating rebuff earlier this month in the Likud referendum, Mr Sharon seems to think he cannot break his pledge to President George Bush that he would withdraw from Gaza. So his decision to send his army into Rafah may be his way of signalling, as a prelude to withdrawal, that he has not gone soft.

A new plan

Now he is set to offer his fractious cabinet a revised withdrawal plan. The main change is that the removal of the settlers would be in four stages, each subject to a cabinet vote, with ministers having a further veto over implementation. Ministers may be forced to vote quite soon—before the attorney-general decides whether Mr Sharon should be put on trial for alleged bribery in a case that has been hovering over him for the past year.

The revised plan, like the previous one, still has no role for the Palestinians. In Mr Sharon's eyes, the PA is worthless as an interlocutor. The Israeli prime minister's aides this week dismissed the Palestinians' latest talk of a ceasefire.

Yet the violence in Gaza suggests that there is a dangerous power vacuum there. Hence, as a result of the flurry of American diplomacy this week in the Middle East, renewed efforts by outsiders, including Europeans, to get a peace process going again, with Palestinians as well as Israelis involved. So far, there is little sign of it. But, as the rally in Tel Aviv suggests, a growing number of Israelis, even on the right, think that, somehow, some Palestinian interlocutors must be found if there is to be a chance even of a preliminary truce.

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Iraq

Who will rule next?

May 20th 2004 | BAGHDAD AND BASRA
From The Economist print edition

The UN's special envoy is finding it hard to choose an interim government

Get article background

Reuters

Farewell to Izzedin Salim

A SUICIDE-BOMBER'S assassination this week of Izzedin Salim, president of Iraq's Governing Council (GC), has darkened the mood in Baghdad's ruling circles but has not stopped the frenetic preparations for a transfer of power to Iraqis at the end of June. Yet the subdued reaction to the assassination among ordinary Iraqis highlights one of the main obstacles to a smooth handover.

Most Iraqis disdain the GC. Many of its 25 members, like the unfortunate Mr Salim, are returned exiles. Few have a popular mandate. Since the Americans set up the council last July, few of its members have tried hard to drum up support in Iraq, preferring instead to travel the globe and to dispense their patronage in the ministries awarded to GC members' parties.

Yet it now seems likely that Lakhdar Brahimi, the UN envoy, who has been entrusted with choosing an interim government of Iraqis to take over in July, will pick many of its new members from the ranks of the GC and will not—as he at first intimated—select a team of technocrats generally unaffiliated to political parties.

Like the Americans before him, Mr Brahimi has had difficulty finding leaders capable of appealing beyond their own narrow sectarian constituencies. Moreover, given the dangers (Mr Salim was the second GC member to be murdered and several more have survived attempts on their lives), many good potential candidates have been reluctant to come forward.

Hence Mr Brahimi may feel he has no choice but to fall back on the GC and on current ministers to find a new team. Several are being touted as a possible prime minister. One, Thamir Ghadban, the deputy oil minister, is indeed a technocrat. Other more plainly political candidates include Mehdi al-Hafez, the planning minister, an old friend of Mr Brahimi; Ibrahim al-Jaafari, head of the Shias' Dawa party, which may be the country's most popular; Ayad Allawi, head of the Shias' Iraqi Nation Accord; and Adel Abdel Mehdi, of the Supreme Council for Islamic Revolution in Iraq (SCIRI). Adnan Pachachi, a venerable Sunni who was once foreign minister, is still tipped to be the interim president.

Most parties represented in the GC have packed the ministries awarded to them with their own members and allies. Mr Allawi's cousin, for instance, is the defence minister. The Americans' latest catchword is “continuity”. Mr Brahimi, it seems, feels obliged to adopt it too.

Many officials in the ruling Coalition Provisional Authority (CPA) admit that they have been distracted by the insecurity of the past two months. But the Americans' decision to accommodate the rebels in Fallujah, to the west of Baghdad, seems to have been replicated elsewhere—and has had some success in ending the worst violence. The idea is to isolate hot spots and pour cash into safer areas. But Iraqi outrage rose this week after Americans killed 40-plus people at what locals said was a wedding, while the Americans said they had hit a nest of foreign fighters.

The Americans seem, for the moment, to be containing Muqtada al-Sadr, the Shia firebrand who has stirred revolts across the south and centre in the past month or so, boxing him and his Mahdi Army into

their holy redoubts in Najaf and Karbala, occasionally clobbering units of it.

It is still unclear, however, just how the transfer of government will take place—and how much power will actually be handed over. On the face of it, the Americans' current proconsul, Paul Bremer, will fly out on June 30th after passing the reins of power to an Iraqi interim prime minister. CPA managers are worried that smaller but nonetheless vital projects may fall by the wayside if unfinished by June 30th. However, an American-created body, the Programme Management Office, will continue to award contracts to take advantage of the $18.4 billion which Congress allocated to Iraq for the current year.

Crucially, it is also unclear what control, if any, it will have over the multinational security forces now trying to suppress the insurgents. Colin Powell, the American secretary of state, stated again this week that if the new Iraqi authorities ask the Americans and their allies to leave, they will do so.

In the south, which has been calmer, British officials fear that aid money may be wasted. “It's going to be a balls-up,” says one of them. “Not enough has been done to prepare for the changeover—but we're just going to have to get by.” It is a sentiment that echoes across the country.

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Zimbabwe

Is Comrade Bob tired of his job?

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Robert Mugabe says he will retire in 2008. But first, he has an election to rig

Get article background

ROBERT MUGABE says he is planning to stand down as Zimbabwe's president in 2008, when his term expires. If he does as he says, his people will have endured his rule for 28 years: a bit longer than Nelson Mandela endured jail.

In an interview published in Kenya's *East African Standard* on May 15th, Mr Mugabe says he is tired of politics and wants to spend more time writing. He laments, however, that he is having trouble picking a suitable successor. Contenders in his ruling ZANU-PF party are fighting and "even going to consult with witchdoctors." They are also, though he does not mention it, energetically having each other's most prominent supporters arrested on corruption charges. Dirt is rather common among ZANU's elite. Last month the finance minister, Chris Kuruneri, was locked up for alleged foreign-exchange fiddling.

Zimbabweans would rather not wait until 2008 for a new president. Their country has grown a third poorer in the last five years, according to the IMF. Both Mr Mugabe and ZANU are wildly unpopular but the old man has a cunning plan to make sure that his party wins the next parliamentary election, which must be held by March next year.

Earlier this month, he expelled a mission from the World Food Programme, which was in Zimbabwe to assess how much food aid the country will need this year. In the absence of such pesky independent witnesses, the government can claim that the recent miserable harvest was in fact splendid, so proving that Mr Mugabe's disastrous land redistribution programme has been a success.

The government cannot maintain this deception until next March, so observers think it will bring the parliamentary poll forward, perhaps to October or November. Mr Mugabe can probably find enough maize to feed his supporters and wavering voters until then.

He will not ask western donors for help, because they insist that food aid should not be used for political purposes. He is hoping that bribing voters with maize meal, combined with the usual ballot-rigging and intimidation, will deliver a fat majority to ZANU. This will put Mr Mugabe in a strong position to pick a pliant successor. Then he might really feel confident enough to retire.

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Nigeria

Falling out, but not yet apart

May 20th 2004 | JOS
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Timid moves to curb fighting between Christians and Muslims

Get article background

AFP

God told them to torch my house

IN THE “home of peace and tourism”, as Nigeria's Plateau state is officially known, fighting between Christians and Muslims has grown so heated that President Olusegun Obasanjo this week declared a state of emergency there. In recent weeks, hundreds of people have died.

Plateau, a mainly Christian state in central Nigeria, has traditionally been calm. So calm, in fact, that refugees from communal fighting elsewhere in Nigeria often sought sanctuary there. In September 2001, however, fighting broke out in the state capital, Jos, between indigenous Christians and newly-arrived Muslims. Perhaps 1,000 people were killed.

This year, the violence flared up again. Earlier this month, Christian militias slaughtered and looted in the town of Yelwa, erecting road blocks to keep out any police who might have stopped them. The police showed little inclination to try. The killings sparked revenge killings: Muslims in the northern city of Kano sought to avenge their fellow Muslims' deaths by killing Christians.

Until this week, President Obasanjo remained oddly silent, not even sending his condolences to the families of the dead. Then, on May 18th, he appeared on television to announce that since Plateau's governor and state assembly were incapable of keeping order, he was dismissing them. A Nigerian newspaper called it the “single most dramatic act” of his five-year rule.

But was it wise? Clearly, Mr Obasanjo is rattled. He fears that the fighting, if not scotched, could spread further. His new appointee as governor of Plateau, Chris Alli, warned that if people did not learn tolerance, Nigeria might end up like Rwanda. That is unduly alarmist, but many local politicians do indeed inflame ethnic grievances to win support. Also, last month, the government claimed to have unearthed a serious “breach of national security”—a polite term for a coup plot—reportedly involving Muslim army officers.

In a country with such fresh memories of military rule, the sight of Mr Obasanjo, a former general, ousting elected politicians by decree worries many. “Dictatorship has been restored,” said Femi Falana, a human-rights lawyer. Others view the move as a sign of weakness. Mr Obasanjo, a Christian, is prepared to invoke emergency powers in a majority-Christian state and to oust a governor from his own party. But he dares not do the same in equally violent majority-Muslim states, for fear of provoking a backlash among Muslims claiming that a Christian president is persecuting them.

So far, Mr Obasanjo has given no clues as to what, concretely, he plans to do with his new emergency powers. Failure to halt the mayhem could be disastrous. But predictions that Nigeria is about to fall apart are implausible. The country hung together despite a civil war in the late 1960s in which a million people died, so it can doubtless hang roughly together now.

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The European Commission

The great selling plate

May 20th 2004 | BRUSSELS
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Our form-guide for the race to be next European Commission president

IT IS a horse-race in which the declared runners carry such heavy handicaps that it is hard to see any of them winning. The conditions are perfect for an outsider to come up on the inside rail. With only a month to go before European Union leaders are due to pick a new president of the European Commission, to serve for the next five years, the field is almost disconcertingly wide open.

The job is critical in European politics. The commission has the sole right to propose EU laws, which now account for half of all new legislation in the 25-member block. It is the guardian of existing EU rules. It initiates actions against members for such offences as illegal state aid, running excessive budget deficits or having filthy beaches. And it is meant to identify the “general European interest”. The commission president can thus combine the roles of a visionary, a deal-maker and a disciplinarian.

The difficulty in finding a candidate to take over from Italy's Romano Prodi stems from some onerous and arbitrary requirements. In theory EU leaders can choose anybody they like. In practice a new president must meet a series of conditions. It is widely held that the president should come from the ranks of prime ministers or former prime ministers. That the most successful recent president, Jacques Delors, failed this test, and that such former prime ministers as Jacques Santer of Luxembourg and Mr Prodi have been notably unsuccessful, have not dented leaders' prejudice in favour of one of their own.

The demands of the European Parliament complicate matters. It insists that any selection must reflect the results of the European elections in mid-June. Formally, the parliament cannot veto the choice, but a parliamentary rejection would be awkward. The centre-right seems likely, but not certain, to emerge as the biggest single parliamentary block, which points towards selecting a centre-right candidate. Because Mr Prodi comes from a big, southern country, the new president would best hail from a smaller, northern European country. And to assuage France's sensitivity about the growing dominance of English, a commission president who speaks little or no French is probably out.

Finding a candidate who ticks all these boxes is hard (see our table below). One possibility is Jean-Claude Juncker, a centre-right prime minister from Luxembourg, indubitably a small country. But there is a feeling that it would be faintly ridiculous to appoint a third commission president from Luxembourg, when Germany, Britain and France have held the post only once each. The British also suspect that Mr Juncker

would be in the pocket of the Franco-German alliance. His appearance at last year's “chocolate” summit, when France, Germany, Belgium and Luxembourg proposed deeper EU defence co-operation heightens such suspicions. But other centre-right candidates—Wolfgang Schüssel from Austria and Jean-Luc Dehaene of Belgium, for example—have been floated without gaining much support.

The runners and riders

Socialist | Liberal | Centre-right

Name	Occupation	Pros	Cons	Odds
Guy Verhofstadt (Belgium)	Prime minister	Multilingual, young, energetic	Despised at home, unpopular with Britain, lightweight	5-1
Jean-Claude Juncker (Luxembourg)	Prime minister	Multilingual, experienced deal-maker	From Luxembourg, ruled himself out, too “old Europe”	5-1
Pat Cox (Ireland)	European Parliament president	Speaks French, popular, good talker	Has never run anything, talks too much	6-1
Chris Patten (Britain)	External affairs commissioner	Experienced, respected, good talker, has bottom	Weak linguist, tired, Britain not in euro	8-1
Antonio Vitorino (Portugal)	Justice commissioner	Very clever, star of commission, multilingual	Low profile, southern	8-1
Günter Verheugen (Germany)	Enlargement commissioner	The other star of the commission	Germany not backing him	10-1
Paavo Lipponen (Finland)	Ex-prime minister	Solid, Scandinavian	Dull, speaks too slowly	15-1
Wolfgang Schüssel (Austria)	Prime minister	Knows new EU countries, skilled operator	Wears bow-ties, had coalition with far-right	20-1
Jean-Luc Dehaene (Belgium)	Ex-prime minister	Clever, acceptable to most countries	Yesterday's man, rejected in 1994	25-1
Bertie Ahern (Ireland)	Prime minister	Good job chairing EU, devious	Too Dublin, monolingual, ruled himself out	30-1

Source: *The Economist*

Faced with such an uninspiring field, European leaders might have to abandon some of their criteria. Could the parliament be persuaded to accept a strong candidate from outside the dominant political group? Or perhaps leaders should go for somebody who has never been a prime minister—such as a member of the current commission?

Guy Verhofstadt, the Belgian prime minister, has emerged as a new favourite in the past week or two. He is a member of Europe's liberal group, which could pose a problem with the parliament, but he is liked by the French and Germans. Unfortunately, he also organised the chocolate summit and is seen as a dyed-in-the-wool federalist—making him even more suspect to Britain than is Mr Juncker.

This points to a wider problem. Any candidate pushed by France is automatically suspect in Britain, and vice-versa. To match British wariness of Mr Juncker and Mr Verhofstadt, the French are hostile to candidates floated by Britain, including two current commissioners, Antonio Vitorino and Chris Patten (the latter pushed also by Valéry Giscard d'Estaing, a former French president), and the European Parliament's Pat Cox. There is a good German candidate who might be acceptable in both Paris and London: Günter Verheugen, who has been a highly successful enlargement commissioner. But he has no backing from the Germans, who have their eyes on the job of vice-president of the commission in charge of economic reform.

Some reckon that, as Ireland holds the rotating EU presidency, an Irish candidate could yet emerge. The Irish have an advantage in that they are native English-speakers without being British. Some suggest that Bertie Ahern, the Irish prime minister, who is leading the search, is secretly angling for the job himself. This week Mr Ahern issued a fairly convincing denial. That leaves Mr Cox, who speaks good French and has impeccable EU credentials. He is a liberal, though the parliament might accept one of its own. But one French official sniffs that he is “too lightweight”.

Sooner or later somebody will have to emerge as front-runner. This time round, no single country can veto a candidate (as Britain did in 1994), because under the Nice treaty the choice is one for a majority vote. The British are increasingly fretful that, in the absence of plausible alternatives, they may end up with Mr Verhofstadt. “You can't beat somebody with nobody,” muses one British high-up.

The broader question is whether the paucity of the field says something about the job. Two weak presidents in a row have seriously diminished the credibility of the commission and its boss. The next president will have a tough job managing a commission that has now swelled to 25 members and also

has a growing credibility problem with big countries like France and Germany. Yet it would be a mistake to write off the commission. Its position is well-entrenched. For better or worse, its next president will still wield great power in the EU.

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Switzerland and the European Union

Big cheese, small hole

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Still a troubled relationship

IN 1946 Winston Churchill went to Zurich to launch his vision of a United States of Europe. Jean Monnet, a founding father of the European project, sought inspiration in the Swiss Alps. The mountain air did not have the same effect on locals. The Swiss have steadfastly refused to surrender sovereignty to the European Union, in its various forms. They have sought rather to prosper as the hole in the cheese.

Switzerland stands out because—unlike Norway or Iceland, say—it is not on the fringes of Europe but at its heart. It has a close linguistic and cultural affinity with its neighbours. Its three main languages are German, French and Italian. All external transport and communications links pass through the EU, which accounts for three-quarters of Swiss trade. Yet any notion of membership remains distant.

Yves Christen, a centre-right parliamentarian who heads a pro-EU movement, says that, if the Swiss ever join the EU, it will be for practical, not visionary, reasons. In a 1992 referendum, a narrow majority (50.3%) rejected the idea of joining the European Economic Area, a free-trade club embracing the EU plus Liechtenstein, Iceland and Norway that was portrayed as a stepping-stone towards EU membership. The rejection marked the rise of the right-wing Swiss People's Party (SPP), which after last year's elections increased its share of power in the government.

The anti-EU lobby, led by the SPP's Christoph Blocher, now justice minister, is strongest in the German-speaking east. It argues against handing “colonial” power to big EU capitals and utters dire warnings of the demise of direct democracy under a Brussels bureaucracy. But Switzerland's economy has faltered over the past decade, and its neighbours have caught up. Pro-Europeans now preach that more open borders and the full panoply of EU single-market rules could stimulate competition and change for the better the sheltered Swiss way of business.

Since the mid-1990s, the Swiss government has been bringing domestic regulations into line with those of the EU. In 2000 a set of bilateral accords, including free movement of workers between the EU and Switzerland, was approved in a referendum. This week, an EU-Swiss summit in Brussels adopted another set of nine accords. They include Swiss participation in Europe's passport-free Schengen zone, and a deal on the taxation of non-resident savings that seeks to preserve Swiss banking secrecy while letting EU

countries tackle tax evasion. The agreement was helped by a Swiss offer of SFr200m ($155m) a year for five years towards funds for the EU's new central European members. Such an *à la carte* approach makes Switzerland more eurocompatible without ruffling feathers.

Yet trouble could still break out. For one thing, the new accords are likely to need approval in a referendum. The elimination of border controls under Schengen will be hard for some Swiss to accept. More generally, several EU members are fed up with Swiss cherry-picking. New member states that pay the club's full entrance fee are not keen on special treatment for Switzerland. Recently the European Commission caused a stir by threatening to tax some Swiss re-exports, and Germany stepped up controls on the Swiss border. Such measures prompted some cantons, half of which border another country, to press for EU membership to be reconsidered.

The government has commissioned a new report on the pros and cons. Yet the chances of joining seem further off than ever. And if the Swiss ever did go for it, they would pose a dilemma. How could the EU cope with a member that called referendums on many significant EU decisions and allowed voters to challenge EU legislation? Even pro-Europeans are not keen to challenge Switzerland's unique system of democracy.

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Kosovo's future

Thick skin required

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The UN needs a new head, and new ideas, for its mission in Kosovo

WANTED: a diplomat from a serious European state with leadership skills, strong nerves, and proven ability to resist manipulation. Balkan experience highly desirable. Sounds like you? Then Kosovo may be yours for the taking. The hunt is on for a new head of the UN mission in the protectorate. Harri Holkeri, an ex-prime minister of Finland who took the job last August, left this week to consult doctors; many say he will not return.

Two months ago Kosovo, technically part of Serbia and Montenegro, but under a UN protectorate, exploded in an orgy of violence. Some 4,100 people—mostly Serbs—fled, and 19 people were killed, as Albanian extremists ran amok. On May 11th Mr Holkeri told the UN Security Council that these events had shaken his mission, known as UNMIK, “to its foundations”. The next day, he collapsed, suffering from fatigue. Some diplomats think that Mr Holkeri's illness has given them a welcome opportunity to replace him. Everybody agrees that the UN mission in Kosovo needs a shake-up. Morale and communication are poor. Worse, Amnesty International alleges that the presence of UN and foreign troops in Kosovo has increased prostitution and people-trafficking. A bizarre recent shoot-out left three Americans and one Jordanian dead.

Kosovo has been left leaderless just when firm leadership is sorely needed. Kosovo's politicians—Serb and Albanian—must be prodded into a dialogue on the future of the province, 90% of whose people are ethnic-Albanian and pro-independence. The other factor in the equation is Belgrade, where interest in Kosovo's future has reawakened recently. Vojislav Kostunica, the Serbian prime minister, is touting new ideas for the province, and has secured their approval by parliament. His plan foresees five Serbian autonomous regions within Kosovo; they would be all but independent of the province, whose final status is left open. Albanian politicians have slammed the idea, but have nothing else to offer. As it stands, Mr Kostunica's plan will not be accepted by the big powers either. But since the recent violence, the debate has moved a bit. Seeing a chance to gain the initiative, Serbia's leaders are talking with a new moderation. Vladeta Jankovic, Belgrade's envoy to London, insists the plan is just a “framework”, or starting-point.

The plan has received mixed reviews from western policymakers. Before the violence, the idea of “decentralising” Kosovo was hardly conceivable. Now it has moved to centre stage. A task-force consisting of envoys from the EU, NATO and America has begun working to get Kosovo's Serbs and Albanians, plus the Serbian Government, to agree to set up a working group. Tortuous as that process sounds, it may clear the way for some trade-offs. The UN will give Kosovo's Albanian-dominated government more power if it countenances a decentralisation plan that would safeguard the Serbs.

On May 21st-22nd politicians from all sides are due to attend informal talks in Switzerland. The Albanians will say that unless Kosovo gets independence there will be more violence. The Serbs may counter with a *bon mot* used by Denis MacShane, Britain's Europe minister, who told Kosovo's president: “The only final status is when we are all dead.”

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Germany's president

In praise of economists

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The case for Horst Köhler

IT WILL hardly be news when Horst Köhler, the former boss of the International Monetary Fund, wins the German presidency on May 23rd. His political sponsors, the opposition conservatives and liberals, have a big majority in the electoral convention. More interesting is that he will be the first economist to occupy the job. Admittedly, the presidency comes with little power. But it offers a platform from which to exert real influence, mainly through weighty speeches. And Mr Köhler comes highly recommended. “He has more economic brains than Germany's entire political class,” according to Helmut Schmidt, a former chancellor who considers himself something of a leading economic light.

Even if Mr Schmidt exaggerates, it is a good moment to have an economist as president—because Germans need a dose of economics to help them grasp the need for painful reforms to boost their economy. Knowledge of economic concepts is as dismal as the science, say opinion polls. In one, only 5% of respondents passed basic financial tests. More than half did not know the difference between a credit and a debit card, or between shares and bonds. Among young Germans, 69% either had not heard of the concepts of supply and demand, or could not describe them correctly. Some 59% had “no idea” what happens on a stock exchange.

Such ignorance may have mattered little during the years of Germany's *Wirtschaftswunder*, when a booming economy underpinned a generous welfare state that took many financial decisions for citizens. But with the country's welfare system in chronic crisis, Germans—like other Europeans—will increasingly have to take care of such matters themselves. What is more, many Germans have a deep-rooted dislike of things economic. To many, market forces smack more of selfishness than of freedom to choose, because they are thought to turn social humans into grasping egotists. That is one reason why so many are suspicious of Anglo-American-style reforms. Gesine Schwan, the Social Democrat running against Mr Köhler, expressed this view when she gave warning against an “economisation of all of life”.

Mr Köhler could use his bully pulpit to enlighten not just fellow citizens, but fellow economists. Academic economists in Germany tend to fixate on rules and targets, such as the arbitrary limits on budget deficits set by the euro-area's stability pact, itself a prime example of German thinking. Similarly, many monetary experts still insist that the European Central Bank should focus on controlling the money supply, just as the German Bundesbank did. In both cases, their American and British colleagues have come to espouse less rigid aims.

Mr Köhler has already said that he will throw his weight around to promote the cause of economic reform. But there is a risk that he himself could turn out to be too much of a dry academic. For Germans need encouragement as well as lessons in economics. The country has fallen into a collective depression that may itself be harming prospects of recovery. This is partly because bashing the country has become such a popular sport. As Johannes Rau, the outgoing president, put it in his last big speech on May 12th: “I know of no country in which so many in office or in charge take such great delight in talking so negatively about their own country.”

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Turkey

Schools for trouble

May 20th 2004 | ANKARA
From The Economist print edition

A row over an education bill has opened old Turkish fissures

HE WAS educated to be an imam. Yet Recep Tayyip Erdogan instead became prime minister of Turkey, which prides itself on being the only secular republic in the Islamic world. Pro-secular Turks now worry that hordes of similarly-trained students may rise to top positions and put the country on a more Islamic path. By making it easier for graduates of state-run religious schools known as *imam hatips* to enter secular universities, a new education bill has deepened those fears—and prompted accusations that Mr Erdogan is increasing Islam's role in public life.

In Turkey, the status of religious schools is not just a matter for academic debate: it goes to the heart of the the country's secular status, of which the army is a zealous guardian. Tension rose when Mr Erdogan ignored a warning about the draft bill from the chief of the general staff, General Hilmi Ozkok—and used his parliamentary majority to ram the bill through.

Secularist fears were fanned when the European Union's envoy in Ankara, Hansjörg Kretschmer, intervened in the debate; he berated the general for meddling in politics. Professors, students and other activists took to the streets, urging Mr Erdogan to back down. Even impartial observers say the bill's timing was bad. In recent months, Mr Erdogan has won plaudits at home and abroad for constitutional and legal reforms that will groom Turkey for the EU. He scored even more points for inducing the Turkish-Cypriots to endorse a UN plan for Cyprus (which was rejected by Greek-Cypriots). The odds are that, in December, Turkey will get its longed-for date for the opening of EU entry talks.

So why couldn't Mr Erdogan have waited until next year to tinker with the ultra-sensitive issue of religious sechools? Some say that praise from Europe and his party's victory in March's local elections have swollen Mr Erdogan's head. Or he may have faced strong pressure from his pious constituents—after shelving other pre-electoral pledges, such as his vow to ease curbs on the wearing of the Islamic headscarf in state-run establishments.

Mr Erdogan says that all he is doing is redressing an injustice inflicted on *imam hatip* students in 1999, when the army insisted they be barred from admission to universities other than theological faculties. In a bid to appease conservatives, the government then extended a similar discriminatory regime to other state-run vocational schools. As a result attendance at both vocational and *imam hatip* schools has fallen sharply, even though many parents choose them for their discipline and quality, not their religious nature. At the Tevfik Ileri Imam Hatip school in Ankara, there is little sign of the Islamic militancy feared by secularists. Boys and girls mingle freely. Besides studying the Koran, they learn the same subjects as they would in secular schools. Like most teenagers, they spend their free time watching rock music on television or surfing the internet.

Abdullah Gul, Turkey's foreign minister, says discriminating against such schools could prompt parents to send their children to radical, underground establishments. “Government control over religious education eliminates that risk, it is the best guarantee for secularism,” he adds. The bill lets vocational-school graduates compete equally everywhere, and *imam hatip* graduates to do so in certain fields. “The claim that *imam hatip* students will flood the universities and go on to become governors, judges and diplomats is nonsense,” fumes Huseyin Celik, the education minister. The real reason for the opposition, he argues, is that the bill undercuts the Higher Education Board, a body created by the generals in 1980.

The Turkish president, Ahmet Necdet Sezer, is likely to veto the bill in the coming days. Should parliament approve it again, he may then appeal to the constitutional court for an annulment. Now that Mr Erdogan has proved his point, some supporters hope he will pull back from the brink and concentrate on other reforms that will do more for Turkey's EU membership bid.

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The Czech Republic

What's in its name?

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In search of a shorter label for the country

BELOVED as it is of headline writers, for whom anything Czech will be in the post on the rare occasions when it is not being bounced or mated, the name of the Czech Republic gives little pleasure to Czechs themselves. It is too formal for everyday use, they say. Nobody takes a holiday in the “Kingdom of Spain” or the “Commonwealth of Australia”. So why must they take one in “the Czech Republic”?

Unfortunately, the Czechs have been unable to agree on a one-word informal name for their country, whether in Czech or English, since the peaceful demise of Czechoslovakia 11 years ago (the other half became Slovakia, which works fine so long as it is not confused with Slovenia). The Czech Senate has just held a public hearing on the issue, which circled, as such discussions always do, around the one or two possibilities that Czechs accept as logical, but cannot bring themselves to love.

One problem is that a short name risks reminding older Czechs of the contemptuous terms “Tschechei” and “Rest-Tschechei” that the Nazis pinned on the rump of the country after seizing the Sudetenland in 1938. Modern Germans have got over this by coining the name “Tschechien”. The Czechs have welcomed this, despite confusion with Tschechenien, the German name for Chechnya, a war-torn bit of Russia.

Yet Czech businessmen still want an official short English name, so that they can brand their goods more snappily. Some have opted for “Made in Czech”. But this is the grammatical equivalent of “Made in British” or “Made in a Briton”: the first nonsensical and the second faintly unsettling. The obvious choice would be “Czechia”, which would complement Slovakia. It has been favoured for years by the foreign ministry and tourist authorities. But the natural English pronunciation, “Check-ee-ya”, grates on Czech ears. They would prefer the ch to be softer, as in the German *Ich*.

The common short name in Czech, “Cesko” (pronounced chess-go), also evokes mixed feelings, but is gaining acceptance for want of anything better. Vaclav Havel, when he was president, said it made his “flesh creep”. Others complain that it evokes the splitting of the country—Czechoslovakia with the Slovakia amputated. And some argue that it sounds too much like Tesco, a supermarket chain prominent in Prague (and noted for its Czech-outs).

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Charlemagne

Those crucial clauses

May 20th 2004
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How special interests infiltrate the European Union constitution

Get article background

IS IT pre-agreement tension, or might it be something more serious? This week European foreign ministers reopened negotiations on the European Union's draft constitutional treaty—and promptly began sniping at each other. The Irish government, which is chairing the negotiations, is hoping to get a deal in June. But with only a month to go, the politicians are proving better at coming up with inventive insults than new ideas. Joschka Fischer, the German foreign minister, accused Britain's Jack Straw of trying to "salami slice" the constitution. Mr Straw suggested that the room was full of "mosquitoes" trying to bite the Brits. Most participants in the talks still bet that there will, just, be agreement next month, but the atmosphere is deteriorating.

The press and politicians are, naturally, concentrating on the big political issues that remain on the table, such as the legal force of the Charter of Fundamental Rights, the voting weights for EU countries and the retention of national vetoes. But behind the smoke of battle, scores of more obscure struggles are being fought. Brussels is abuzz with the sorts of lobbyists that are more commonly found on Capitol Hill in Washington, working overtime to get a few words changed or inserted that may matter not a jot to the average citizen, but are crucial to particular businesses or interest groups. For the constitution is more than a codification of existing EU law. Dotted throughout its 305 pages, 472 articles and seven protocols and declarations are lots of little twists and details—adding an EU power here, refining a power there—each of which is of vital importance to somebody.

Take four current examples: oil, tobacco, animal welfare and sport. When the draft constitution emerged from the European Convention charged with preparing it about a year ago, the big oil companies were aghast to discover Article III-157, which appeared to give the EU the right to pass laws to "ensure security of energy supply". Companies such as BP and Shell sounded the alarm in London, arguing that the clause might mean that North Sea oil could, ultimately, be controlled from Brussels. An outcry about Europe grabbing British oil was stirred up in the press; BBC correspondents sent dramatic dispatches from oil rigs in the North Sea. Under heavy pressure, the British government successfully got some changes made to the text, seeking to make clear that member countries will retain control over the exploitation of their own energy resources. But this week, it went one better: the entire energy clause was scrapped.

The oil companies will be delighted. But the newest iterations of the draft are bad news for the tobacco industry. A revised version of Article III-179 on health that was released by the Irish earlier this month has suddenly introduced a new right for the EU to make laws "which have as their direct objective the protection of public health regarding tobacco and the abuse of alcohol." The cigarette-makers detect the influence of anti-smoking zealots in the Irish government, which recently passed the first law in Europe to ban smoking in the workplace (including in pubs and restaurants). Similar legislation at European level would be a nightmare for the manufacturers. But the lobbyists, acting for an unpopular industry, have to tread carefully. Their chosen tactic is to persuade European governments that the text poses a serious threat to countries' right to manage their own health systems. The same article that mentions tobacco suggests that the EU should be able to take action to combat any serious health threat that affects more than one member country.

With less than a month to go, the tobacco industry risks running out of time. Luckier special interests had their concerns met months ago. Animal-rights lobbyists had failed to persuade the convention to include a specific reference to animal welfare in the draft. But when the text was handed over to the politicians, they hit on the wheeze of organising a drawing competition for children across Europe in support of their furry friends' right to constitutional protection. The winning entrants were rushed to a foreign ministers'

meeting last November, in the correct calculation that no politician could refuse to meet a child clutching a drawing of an animal. And the result? A new clause in the constitution, insisting that the rights of animals must be taken into account by the EU in all its activities.

Going for goal

If cats and dogs rank high in the affections of European voters, so do footballers. And their fate will also be affected by the new constitution. In recent years UEFA, the body that regulates soccer in Europe, has been increasingly irked by the way that EU laws on competition and the single market have affected the beautiful game. Court decisions and commission rulings were forcing clubs to adjust their practices on everything from players' contracts to television deals, often with serious financial consequences. Article III-182, as it emerged from the convention, provided that “the Union shall contribute to the promotion of European sporting issues” and develop the “European dimension in sport”, as well as “protecting the physical and moral integrity of sportsmen” (best of luck, on this last point).

This is the first time the EU has claimed power over sport in its basic legal documents. UEFA was alarmed that it might herald a fresh barrage of legislation. So it launched an energetic lobbying campaign that has now managed to get the phrase “taking account of its special nature, its structures based on voluntary activity and its social and educational function” inserted into a new draft. The hope is that this phrase will provide a legal basis to argue that sport can, in certain circumstances, be exempted from the usual strictures of the EU's single-market rules.

What such an ambiguous qualifying clause will mean in practice is a matter for conjecture and argument. One thing is for sure in Brussels (just as in Washington): the constitution's provisions on sport, animals, health and a myriad other issues will provide years of lucrative employment for lawyers.

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Britain's Olympic bid

London's Olympic spirit

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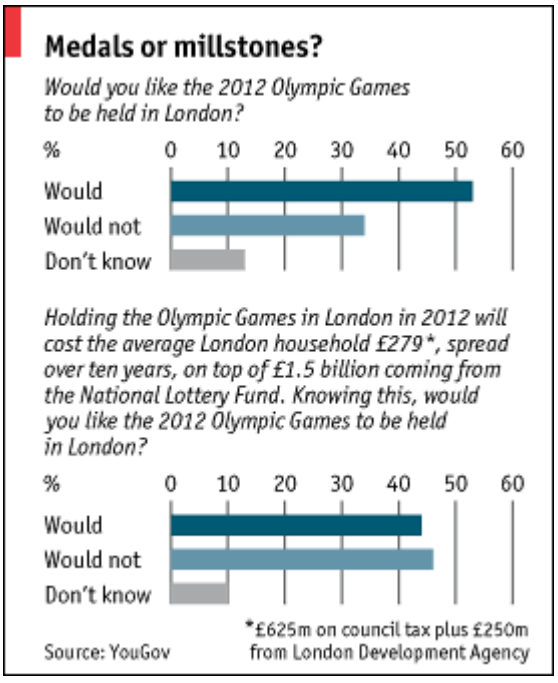
Britain last hosted the Olympics in 1948. Londoners, like economists, aren't much more enthusiastic this time round

GIVEN the amount of sniggering the Greek government has had to put up with over its stadium in Athens, currently sitting roofless in the dust like a discarded oyster shell, it is perhaps surprising that there is a queue to host the Olympics. Yet the shortlist of cities for the 2012 Games, announced by the International Olympic Committee (IOC) on Tuesday, is the most competitive ever. London is on it, along with three other capitals—Paris, Moscow and Madrid—and New York.

London has some good plans too. They involve picturesque locations like Wimbledon for tennis and Lord's cricket ground for archery. Horse Guards Parade would be used for beach volleyball and Hyde Park for the triathlon.

Good plans are not enough, though. A winning city needs a professional team pushing the bid and the power of public opinion behind it. It is not clear that London has either. Barbara Cassani, an American whose charm and determination had won over many sceptics, resigned as head of the team when the shortlist was announced. The Olympic lobby was shocked. Some blamed anti-Americanism. She has been replaced by Sebastian Coe, who used to be a fine athlete but has yet to prove himself as a manager and hustler.



Nor are Londoners wildly enthusiastic (see chart). Politicians share their ambivalence. Britain got going late because the government dithered for nearly a year. Tony Blair has voiced his support, but not as loudly as France's president, Jacques Chirac, who likes to wander into Olympic press conferences and do a little publicity for the Paris bid. Tessa Jowell, the minister responsible for sport, has none of the clout of her French counterpart, Jean-François Lamour, twice a gold medal winner for fencing. Gordon Brown, the chancellor, is said to be against the bid.

Though financial disasters like the Montreal Games are now rare, few Olympics manage to turn a profit.

The exceptions, like Los Angeles in 1984, do so by not building much new stuff. London, by contrast, is planning a 500-acre Olympic park, complete with athletes' village, indoor arenas and swimming pool, in the lower Lea Valley, an unloved bit of east London.

The Olympics' supporters argue that, even if they made a loss, the wider boost the Games will bring would be worth it. The evidence for this is shaky. Robert Baade, an economist at Chicago's Lake Forest College, says that the perceived benefits of a successful Games like Sydney tend to be offset by the number of tourists who stay away. He also reckons that increased economic activity in the host city has come at the rest of the country's expense.

There is little data on the economic impact on Olympic cities, but Mr Baade studied what the 1994 soccer World Cup did to its nine American host cities. They had been expected to benefit from a $4 billion economic boost. Mr Baade reckons that, instead, the event depressed growth, as some tourists kept away to avoid football fans. Stefan Szymanski, of Tanaka Business School at Imperial College in London, also doubts the economic claims made for such events. “The Olympics is like having a big party and building a bridge that everyone crosses once,” he says.

All the candidate cities face this problem. But London has a particular difficulty. In its report on the shortlist, the IOC described London's rail system as “often obsolete” and the roads as congested.

Part of the problem is that, until recently, it had been assumed that the Olympics would hasten, and benefit from, Crossrail, a long-mooted plan for a high-speed east-west railway across the city. An unpublished report by Arup, an engineering firm, for the British Olympic Association and the Greater London Authority, says that “without Crossrail and without event rescheduling (ie, the worst-case scenario) the network cannot cope with the expected level of demand.” Event rescheduling—fitting the Games around London's commuters—is not popular with the IOC. And now nobody expects Crossrail to be built in time.

The Arup report is also gloomy on the economics of the Games. It estimates the balance of costs and benefits at somewhere between a surplus of £82m ($145m) and a loss of £145m.

London's Olympic bid does have one prominent friend, however. The mayor, Ken Livingstone, has recognised an opportunity to force central government to spend lots of money on London's transport. The pressure has already started: as soon as the shortlist was announced, the bid's leaders said that without increased spending London would lose.

Fixing the transport would be popular. But Londoners, it seems, could do without the Olympics that go with it.

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Stem-cell research

Branching out

May 20th 2004
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Britain opens the world's first stem-cell bank

MANY people worry that Britain's biotech sector is falling further behind America's. Yet in at least one field Britain is pressing ahead: stem cells. On May 19th in Potters Bar, a north London suburb not previously known as a high-tech hub, the world's first human stem-cell repository, or “bank”, opened. Scientists can use it both to deposit their laboratory riches and to make withdrawals.

While most of the body's cells are locked into a single job for life, stem cells are able to reproduce themselves repeatedly, and can mature into a wide range of different cell types. This makes them a potential source of new cells to repair damaged tissue in, say, diabetes or Parkinson's disease. Human stem cells can be derived from adult tissues, but the most versatile ones come from embryos. Anti-abortionists therefore disapprove. Three years ago, Britain established strict guidelines to govern both the creation and the use of embryonic stem cells in the laboratory—regulations which now serve as a model for other countries.

The new publicly funded stem-cell bank builds on this precedent. The bank will accept deposits of stem cells from public and company labs, subject to both scientific and ethical approval by its steering committee, which is also in charge of vetting applications for withdrawals. The bank's own scientists will do the laboratory legwork to fully characterise the deposited cells, and grow them in sufficient quantities, and to a quality, that they can be shipped to labs worldwide. Two embryonic stem-cell varieties from British research groups have already been deposited, and the bank has capacity for thousands of lines. It hopes to see the first withdrawals by the end of the year.

The bank will be a boon to Britain's ten or so groups working on stem cells, says Stephen Inglis, head of the National Institute for Biological Standards and Control, which is hosting the bank, in part by attracting more scientific talent to Britain. And it should benefit scientists everywhere by making top-quality embryonic stem-cell varieties more widely available.

But the benefit to Britain's biotech industry will be longer coming, says Simon Best, head of Biotechnology Industry Association Scotland. While access to more research material is useful for fledgling companies, the real limit on commercial development is uncertainty among investors that the products of stem-cell research will be welcomed in America, the world's richest health-care market.

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Celltech

The Belgians are coming

May 20th 2004
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Horror at a foreign bid for a British biotech outfit

CELLTECH is Britain's number-two biotech company. In 1999 its sales were only £44m, but reached £353m last year, and due on the market in 2007 it has an anti-arthritis drug which, it hopes, may alone bring in £600m. But this week it got a £1.5 billion ($2.7 billion) bid from a Belgian company, UCB. The board backs the bid, and it will probably go through, given that Celltech has licensed the marketing rights to its new drug to the Belgians anyway.

Celltech plainly needed a big ally, or a bid. It has some decent products: two against coughs, one for attention deficit hyperactivity disorder, all sold in America. But—especially there—success depends not just on good products but also on a substantial sales force. Celltech could not build that on its own: whatever its prospects, it has lost £600m, pre-tax, over the past four years, and brokers' estimates of profit this year run only to about £50m. It did have a deal with Pfizer, a giant American company, to sell its new drug, but last autumn Pfizer dropped out.

Enter UCB, once in heavy chemicals, now in specialty chemicals and pharmaceuticals: it makes a hay-fever remedy, for instance. Its first interest was in the marketing rights for Celltech's arthritis drug. But it saw the logic of a bid. Its drugs sales are three times Celltech's; jointly, the two can make a fair showing. Yet it cannot bring the sales impact that a bigger, purely pharmaceuticals, partner might. The bid will benefit Celltech, but one can imagine better.

In Britain, the bid is widely seen as a blow to national pride. Press comment implies that Celltech, and with it the flower of Britain's nascent biotech industry, is vanishing abroad.

Its profits, if they come, may. But its research will still be done in Britain, with more work coming in from UCB; and the research brings the well-paid jobs for well-qualified staff that Britain should be angling for. What's more, as part of a bigger group, Celltech has a better chance of flourishing than it would as a lone, struggling (but oh-so-British) minor company.

Anyway, the idea of “British” companies does not mean much these days. Celltech certainly was “British” when it was set up as a state enterprise in 1980. But it floated in 1993—and a third of its equity is now held by institutions, notably Capital Group and Fidelity, headquartered respectively in California and (under American control) Bermuda.

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Newspapers

Tweedy not weedy

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When shareholders get heavy

OWNING a British tabloid is not for the timid. Truculent, expensive journalists write lurid, loosely-sourced stories (along the lines of “Sex-change Nun in Royal Rape Threat”). There are frequent spats with libel lawyers, government and public opinion.

Piers Morgan, editor of the *Daily Mirror*, Britain's third-biggest daily, for nearly nine years, was not timid: indeed he was once described as having “more balls than brains”. His misjudgments before being sacked last week included buying shares that the paper was about to recommend, and a front-page headline, crassly evoking wartime anti-German feelings, during the Euro 96 football tournament.

His downfall came over some photos purportedly showing British troops abusing Iraqi prisoners. These turned out to be fakes, and fairly clumsy ones at that. Mr Morgan, who had doggedly insisted that the pictures were “accurate” despite a startling lack of supporting evidence, was fired by Sly Bailey, Trinity Mirror's chief executive, with such immediate effect that he left the building minus his jacket.

So far, so normal, in the lively world of British popular journalism. The unusual twist to the story is the role played by Trinity Mirror's institutional investors, and particularly Tweedy Browne, an American fund well known for its remorseless pursuit of underperforming managers. It was one of a number of institutional shareholders to express concern at Mr Morgan's near-suicidal defence of the photos in the week leading up to his sacking. Some think that this is a sinister new tendency: if British journalists aren't free to write stories (or print fake pictures) without foreign financiers interfering, an ancient tradition of editorial freedom is in danger.

The truth is more complicated. It is true that Tweedy Browne has shown an unusual interest in the inner workings of the *Mirror*. After a front page headline on July 4th 2002 describing America as “the world's leading rogue state”, a senior figure at Tweedy Browne phoned Ms Bailey's predecessor, Philip Graf, to find out how what he saw as factual inaccuracies in the article had come to be printed. That showed no disrespect to editorial freedom, a Tweedy Browne insider explains, it was just a reasonable inquiry about how much freedom line-managers had in that particular bit of the business.

The fund became increasingly unhappy about Mr Morgan's loose ways with the truth. A drawn-out scandal over the photos, it felt, could potentially damage the paper as a business. It insists it is not interested in politics, only in the reputation of the media outlets it owns, and especially the harm done by “inaccuracy”. Certainly other institutional shareholders were also unhappy with Mr Morgan's dogged defence of the spurious photos, although it was Tweedy Browne's discontent that became public first.

Tweedy Browne also holds shares in the parent group of the upmarket *Independent*. With its Sunday sister paper, its coverage of the Middle East is regarded with horror by American conservatives. “The *Independent*'s stance has been the most anti-war in Britain and I've never heard a squeak from any institutional shareholder in the UK or anywhere else,” says Ivan Fallon, the papers' chief executive.

Although Ms Bailey's cost-cutting had improved Trinity Mirror's fortunes, the Mirror papers' circulation was still falling fast—largely because its mainly male working-class readership is the most pro-war bit of the population. It was that which really got the owners worried.

The idea of sinister foreign interference bears little scrutiny. Trinity Mirror is unusual in having a lot of smallish shareholders. Most other papers are owned by a tycoon—such as Rupert Murdoch, Lord Rothermere, or until recently Conrad Black. Their hands-on style makes Tweedy Browne's tweaks on the tiller seem tame by comparison.

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Wealth

Easton promise

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Only the fittest survive in the shires, and Lord Hesketh isn't among them

GRAND houses don't come much swisher than Easton Neston, a baroque pile on the market for around £50m ($90m). After 470 years the Hesketh family is selling up: running costs for the 54-room house are too high.

Evolution's like that. People whose habitat is big country estates need to be good at hunting money. That can be by marriage—wise alliances with American heiresses by past generations enriched the Hesketh treasury—or from business sense. The canny owner-occupiers of other big houses have made them into thriving businesses, with model railways, safari parks, paintballing and other plebeian attractions.

Lord Hesketh likes showing off his house to guests, but not that much. And his business skills have not matched his outsize talents in other areas. He has used up his time, energy and cash on unprofitable ventures such as racing cars, motorbikes and the Conservative Party.

A foreign species is the most likely replacement for the Hesketh. Until recently, Arabs were the commonest customers for English stately homes. Now the cash is flowing into the shires from other regions. Roman Abramovich, a Russian billionaire who has already snapped up one of the top global status symbols, an English football club, is talked of as a possible new owner. After the robust challenges of post-Soviet business practices, even the oddest bits of English country life should seem quite manageable.

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Students and cities

The new blacks

May 20th 2004 | LEEDS
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A different kind of ghetto emerges in Britain's cities

A HANDFUL of permanent residents remain in Manor Avenue. One of them is trying to move out. It is not hard to see why. The street has come to resemble a slum, with potholes in the road and gardens concreted over to make them easier to maintain. Most of the terraced houses are filled with unruly, transitory tenants who feel little connection to the neighbourhood. They are not poor (at least, not in a social-class sense) but young, which, if you are a home owner, may be worse.

In Headingley, a formerly quiet suburb of north-west Leeds, students are regarded with the same sort of distaste that the inhabitants of 1950s London reserved for West Indian immigrants. The sense of panic in the face of an invading army is the same, too. “When the proportion of students in a neighbourhood reaches about 40%, the other properties tumble like a row of dominoes,” says David Morton, a local Liberal Democrat councillor.

All over Britain, young people are moving into neighbourhoods and everyone else is moving out. Two geographers, Phil Rees at Leeds University and Danny Dorling at Sheffield University, have compared census returns from 1991 and 2001. They find that generations no longer mix so freely: Britain is polarising by age. In 1991, just 3% of 18-19-year-olds and 8% of 20-24-year-olds would have had to move in order to distribute themselves evenly across local-authority boundaries. By 2001, the proportions were 8% and 12%. The distinctions are much starker in a number of urban areas: if Headingley were to look like a normal neighbourhood, more than half of its residents would have to clear out.

There are several reasons for this trend. In some city centres, growing pub and club clusters have lured young people and deterred everyone else. But in Leeds it is a process of “studentification”. The city's two major universities have swelled rapidly, enrolling 74,000 customers last year compared with just under 40,000 in 1993. But their housing stock has barely enlarged. Only a quarter of full-time students found university accommodation this year. The rest have been thrown on to the local housing market.

Students, and the landlords who rent to them, can nearly always outbid the competition. This is not

because students have a lot of cash to spend (in Leeds, most will shell out £50-65 per week for a room) but because they tolerate, indeed prefer, living on top of one another. And if concentrated spending power does not drive established residents out, noise and heroic acts of drunkenness will.

Recently, griping about young interlopers has been replaced by political action. The national campaign is led by Harold Best, MP for Leeds North West, who got interested in the topic when students moved in next door. Together with MPs from other studenty cities (Birmingham, Nottingham, Newcastle) he has pushed for tough clauses in the Housing Bill, now before the House of Lords, which will require many student landlords to be licensed.

That is small beer compared with plans now being concocted in Leeds. This September, the city is likely to delineate an “area of student housing restraint” covering Headingley and parts of the neighbouring Kirkstall, Weetwood and University wards. New building will be halted in the area, together with things like attic conversions, unless owners promise never to rent to students. Changes to the planning code are in the works, too. “Our strategy is to grasp at any straw that will make life more difficult for student landlords and letting agents,” says Richard Tyler, a former lecturer at Leeds Metropolitan University who leads the local campaign.

Are these measures really justified? Students do not make for peaceful or sweet-smelling neighbours, but their persecutors seem to have overlooked a few details. For one thing, there is the effect on property prices. Terraced houses are worth 24% more in the local LS6 postcode district compared with the rest of Leeds, according to Hometrack, a property consultant. And, as Mr Morton points out, the young population supports a high density of banks and cinemas as well as bars. Other neighbourhoods equally distant from the city centre are instead filled with boarded-up houses and shops.

Freda Matthews, who heads the Little Woodhouse Community Association, admits that the alternatives to studentification may be worse. “People who are anxious to get rid of students don't realise that families are unlikely to return to these areas,” she says. “In any case, people have been able to sell up and make an absolute mint. They wouldn't have made their fortune any other way.”

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Pensions

Occupational hazard

May 20th 2004
From The Economist print edition

Why the government forked out £400m for pensioners

WHEN Allied Steel and Wire (ASW) went into receivership in 2002, the company's pension fund could meet only a fraction of its commitments. Its laid-off workers now number among the estimated 60,000 people who have lost some or all of their pension entitlements when their companies wound up occupational schemes, often under pressure of insolvency. Their plight, which had already attracted the sympathy of backbench MPs and the backing of unions, has now succeeded in prising open the government's purse strings. The pensions bill, on its way through Parliament, has been amended to provide £400m to those short-changed by insolvent employers' imprudence with their funds.

That sum will not make good their losses. It may not even restore the public's badly-shaken faith in occupational pensions. It may, however, be enough to win over the rebellious Labour MPs the government needs to get its pensions bill passed.

Robert Maxwell's theft of millions from the pension fund of his Mirror Group Newspapers prompted the first attempt to protect pensioners in 1995. The law obliged companies to pay existing pensioners in full and forbade them from emptying their pensions pot below a so-called minimum funding requirement (MFR). But the failure of ASW exposed the flaws in this legislation. Despite meeting the legal minimum, the scheme's assets fell woefully short of its liabilities. And because existing pensioners had first claim on the fund, longstanding contributors to the scheme who had yet to retire were pushed far down the pecking order and saw little of the cash they had saved through their working lives.

The Labour government has been slow to redress these flaws, and has in some cases made them worse. Twice it relaxed the MFR, for example. Its new pensions bill is a more thorough-going effort to learn from the failures of the past. It will create a regulator to promote better management of schemes and an insurance pool to bail out those that fail anyway.

But insurance cannot cover risks that have already materialised. “None of us, taking out car insurance next week, would expect it to cover us for an accident that we had last week,” said Andrew Smith, secretary of state for work and pensions, in a Commons debate. The casualties of these past accidents must instead make do with some share of £400m. The proposed sum falls well short of the £76m a year for 30 years that Ros Altmann, a specialist on pensions, reckons it would take to compensate all of the aggrieved members of wound-up schemes.

The government is not, it insists, providing “compensation”, which would imply full recompense for a harm it had caused. It is not liable for a company's failure to keep its promises. But it is, as it found out this week, politically liable for anything grey voters and its own backbenchers wish to lay at its door.

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Broadband

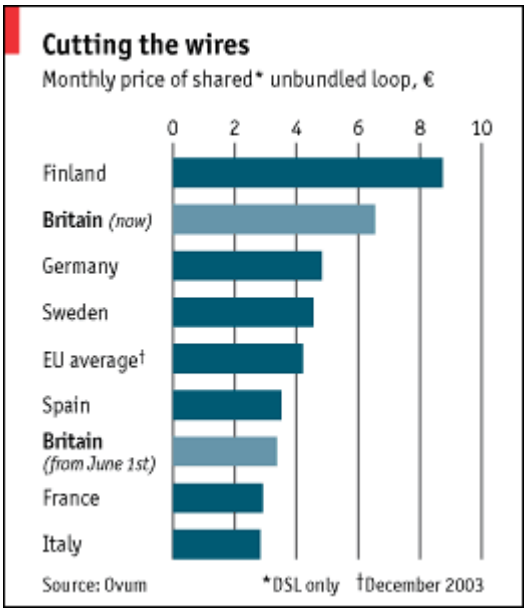
Beating up BT

May 20th 2004
From The Economist print edition

Why BT has suddenly decided to cut its wholesale prices

HAS Ofcom, Britain's new communications regulator, won its first victory over BT, by scaring it into making huge price cuts? It certainly looks that way. On May 17th, BT announced dramatic reductions—of up to 70%—in the prices it charges rival operators that offer high-speed (broadband) internet links over its network. The announcement came days after Ofcom unveiled the first of several reports into the state of Britain's telecoms market, in which it criticised BT's high wholesale prices and alluded to the possibility of breaking the company up. Is that what prompted BT to cut its prices?

Certainly not, sniffs BT. While its actions might appear to have been prompted by fear of break-up, it says it was responding not to Ofcom's stick, but to its carrot.



At the moment, BT shares its network with rival broadband providers in three ways. First, it offers them its own broadband services on a wholesale basis, for resale under their own brands. BT makes a good margin, and the rival operator does not have to build anything. Of the 2m or so broadband connections delivered over telephone lines in Britain, BT retails around half of them itself, and acts as a wholesaler for the rest in this way.

Second, under a scheme called “local loop unbundling” (LLU), the rival operator can install its own equipment in local exchanges and lease BT's lines for the “last mile” from the exchange to the subscriber. This involves a lot more investment—rival operators need their own high-speed “backbones” to link up the exchanges—but allows them to differentiate themselves from BT. Uptake of LLU has, however, been slow: fewer than 10,000 lines have been unbundled.

Last week, BT said it would reduce the prices of unbundled loops by around 35% from June 1st, with further cuts to come. But while the monthly cost per unbundled loop has fallen, the set-up charge for each one is still 50% above the European average, says Serafino Abate of Ovum, a consultancy. So there is room for more cuts. And while revenue per loop will fall, BT should benefit as the overall market grows.

BT's aim is to encourage rival operators to pursue LLU and not its third broadband service, called DataStream. This is a halfway house between the first two options, forced on BT by regulators, in which rival operators use BT's backbone as well as their own infrastructure, providing some scope for differentiation. BT says this is unfair, since it allows its rivals to piggyback on the whizzy new backbone it is now building. It would much rather its rivals simply resold its broadband products, or built their own backbones and used LLU.

With its new LLU prices, says Andrew Darley of ING, an investment bank, BT has now made LLU cheaper than DataStream. It has done so because Ofcom has said that if LLU takes off, it might relax the regulatory requirements around DataStream. It is this carrot, rather than the stick of break-up, that has prompted BT to act.

What is striking is that there is suddenly agreement across the industry that “infrastructure-based competition”—in other words, more LLU—is the way forward. BT has historically been reluctant to push

LLU, but has now decided that doing so is in its best interests. Conveniently, many of the rival firms that hoped to exploit LLU have gone bust (thanks, in part, to BT's previous delaying tactics).

The change also reflects BT's greater confidence that Ofcom will reward it for doing so by relaxing regulation elsewhere. It will lead to more competition, which is Ofcom's aim; and it will make life easier for BT's rivals, which have welcomed the news. It looks like a victory for Ofcom. But that does not mean it is a defeat for BT.

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Bagehot

The Labour Party and the dinner party

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Tony Blair's position is stronger than fashionable opinion appears to suppose

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WHAT a difference a week makes. The wave of panic that washed over Labour MPs as they digested the dreadful images from Abu Ghraib has, for now at least, largely dissipated.

This is deeply frustrating for much of the up-market media and its audience, which has settled on a narrative which requires, at some point in the next few months, Tony Blair to be engulfed by the unfolding catastrophe in Iraq. Among a large chunk of the chattering classes it is now fashionably assumed that Mr Blair is done for and there is a growing impatience to be proved right. Labour MPs are not immune from this—they go to Islington dinner parties, they listen to the BBC's "Today" programme and they read the *Independent* and the *Guardian*—but those who are actively hoping for such an outcome are a surprisingly small, possibly even diminishing, minority.

There are several explanations for the apparent disconnect between the Labour Party and metropolitan *bien pensant* opinion. In the first place, although there is an abundance of criticism for the way the Americans are handling things in Iraq, there is widespread acknowledgment that the British are doing a pretty good job under difficult circumstances. There was a deep sense of relief on all sides of the House of Commons that British forces appear not to have been involved in anything remotely comparable to the systematic abuse of Iraqi prisoners by their coalition partners. There were very few MPs who did not raise a muted cheer at the sacking of Piers Morgan, editor of the *Daily Mirror* (see article), after the newspaper's pictures of supposed abuse of prisoners turned out to be fakes.

The sense that the media is trying just a little too hard to foment a leadership crisis may even be helping Mr Blair. After finding himself at the centre of the speculation that dominated the weekend papers, John Prescott, the deputy prime minister, addressing a packed meeting of Labour MPs on May 17th, succeeded in turning the whole thing into a joke.

The deputy prime minister had talked mysteriously to the *Times* about "plates...moving" and ministers positioning themselves. With his talent for mangling meaning out of the simplest sentence, Mr Prescott ruefully admitted that he had grown used to misinterpretation. According to another report, he and Gordon Brown, the chancellor, had secretly discussed how to achieve an orderly succession while sitting in the car park of the Loch Fyne oyster bar in Argyll after commemorating the tenth anniversary of former Labour leader John Smith's death. There was, Mr Prescott, explained, a more mundane explanation for his sojourn at the restaurant: he had bought some kippers after the car he was travelling in had suffered a puncture. Even the normally dour Mr Brown laughed.

But it was not just Mr Prescott's knockabout style that helped to change the mood at Westminster. Last weekend saw the first large-scale canvassing ahead of next month's local government and European Parliament elections. MPs, who had left London for their constituencies on Friday in trepidation, returned on Monday visibly uplifted. Among its traditional supporters, the government was getting credit for the strong economy and high public spending. To some people, Iraq matters more than anything else; but to most, it matters fairly little. A low turnout on June 10th will still make it a night to forget for Labour, but the canvass returns and some private research carried out over the past fortnight by Philip Gould, Mr Blair's polling guru, have reassured MPs that nothing seismic has occurred.

Mr Brown has also helped calm things down. Some of his supporters, especially those who imagine themselves in ministerial cars when the great day dawns, become a little frenzied whenever Mr Blair is going through a sticky patch. In the past, Mr Brown has not always discouraged them as vigorously as he

could. But that has changed.

The chancellor has made it clear over the last few days that any attempt to destabilise Mr Blair will damage Labour's election prospects and that he will not tolerate it. Whether or not there is, as most people now believe, an understanding between Mr Blair and Mr Brown about a handover within the next two or three years, both men have a shared interest in the prime minister leaving office on a high rather than a low note: Mr Blair is concerned for his legacy, Mr Brown for his inheritance.

After Eden?

Some of Mr Blair's antagonists think back fondly to the way the Tories dispatched Margaret Thatcher in 1990 over another unpopular policy, the poll tax. But Labour's situation now is quite different to the Conservatives' then. The Tories knew that the only way to get rid of the policy and stave off electoral defeat was to change their leader. Labour knows that changing its leader will not change the policy in Iraq: whoever is prime minister, the government cannot contemplate cutting and running.

As for Mr Blair, he sees a rocky path between now and next January, when elections in Iraq are scheduled, but continues to believe that, if America learns from its mistakes, Iraq is reparable. To that end, he worries almost as much about the degenerating relationships within the Bush administration and the danger of increasing domestic pressure for a speedy American exit as he does about the problems on the ground in Iraq.

Mr Blair is under no threat from his own party, but he remains at the mercy of events that he cannot control and may only marginally influence. He has concluded that if his venture in Iraq were to end in unambiguous strategic failure, it would be dishonourable to carry on as prime minister. In which case his departure from the scene would resemble that of Anthony Eden in 1956 more than that of Margaret Thatcher, only in infinitely worse circumstances. Such an outcome would no doubt give the dinner-party tendency great pleasure.

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Having it both ways

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From The Economist print edition

AP

Opinion about Russia under Vladimir Putin is more divided than ever. Gideon Lichfield tries to reconcile the opposites

Get article background

“THE sovereign must be autocratic,” said Catherine the Great, “for no other form of government but that which concentrates all power in his person is compatible with the dimensions of a state as great as ours...Any other form of government would be not only harmful, but utterly ruinous for Russia.”

After several centuries of autocracy and 13 years of what they were told was democracy, most Russians would side with Empress Catherine. Boris Yeltsin, hailed as Russia's first democratic leader, spent nearly a decade presiding (or rather failing to preside) over ruinous near-anarchy. Vladimir Putin, specially plucked from obscurity to be Mr Yeltsin's obedient successor, has turned out to be nothing of the kind.

Russians admire his youth, sobriety, steely restraint and love of order, and many find their own lives better and calmer. Foreign investors who ran away after the government default and economic crash in 1998 have flocked back. They extol the increasing stability of the economy, the growing power of consumers, the energy and imagination of entrepreneurs. They are convinced that the president and his economic reformers want to remove the distortions caused both by Soviet socialism and by the post-Soviet, crony-capitalist gold rush, and create a land in which the free market can flourish. They too will say, quietly, that the empress had a point.

But both Russian and western political liberals look at Russia with a tightening knot of fear in their bellies. They see an authoritarian leader who has repressed the media and free speech, planted former secret agents and soldiers throughout the government, and turned both houses of parliament into dispensers of rubber stamps; who has encouraged the resurgence of nationalism and allowed the conflict-ridden republic of Chechnya to become a morass of banditry and killing on both sides; who has shown his taste for power and distaste for business by persecuting Mikhail Khodorkovsky, Russia's richest man; and whose “reforms” are at best ineffectual and at worst a charade.

The biggest land-mass, the coldest places, the greatest riches, the cruellest rulers on earth: an extreme land provokes extreme views. But today they seem more divided than ever. Sometimes one wonders if people are talking about the same place. An article in the *New Republic* in February by Masha Gessen, a leading Russian-American journalist, accusing the American media of largely ignoring “the death of Russia's nascent democracy” under Mr Putin, started a furious debate on *Johnson's Russia List*, the online forum of the small international community of English-speaking Russia-watchers. A few weeks later an article in *Foreign Affairs* by two scholars, Andrei Shleifer and Daniel Treisman, provoked another row. The authors berated the press for exaggerating Mr Putin's autocratic bent, and argued that on just about any measure Russia is now “a normal country”, doing no worse than the average in the developing world.

One of the things that developing countries take time to establish is a consensus about what they should be developing into. Russia has a special knack for confounding predictions. In the heady days of the early 1990s many assumed that the wave of democratic feeling that had washed away the Communists would permeate everything and that Russia, having been a Communist superpower, was well on the road to becoming a capitalist, democratic one.

But the new regime was more fragile and corruptible than anyone had imagined. It twisted the notions of capitalism and democracy out of all recognition. Under Mr Yeltsin a small cabal of magnates, the “oligarchs”, obtained much of the country's industry and natural resources on the cheap in return for supporting the president. Economic disasters repeatedly swallowed up ordinary people's savings. Political parties came and went like puffs of smoke. Not until last December's parliamentary elections, which wiped out the two small liberal parties, Yabloko and the Union of Right Forces, and filled the Duma with grey Kremlin yes-men, did it finally hit home that Russians had found their “democracy” to be as shoddy as anything they used to buy in Soviet-era shops, and were content to let it go. That bitter disappointment is one reason for the lack of consensus today.

Call me unpredictable

Another reason is that Mr Putin, on whom everything in Russia is perceived to depend, also has a knack for confounding predictions. In the autumn of 1999 Mr Treisman, blissfully unaware (like everyone else) that the then prime minister would soon take over the country, argued in *Foreign Policy* that the next president—whoever he might be—would remain shackled by the powerful oligarchs, renegade regional governors, corrupt officials and querulous parliament that had hobbled his predecessor. “Probably about a year after he moves into the Kremlin,” Mr Treisman wrote, “Russia's next president will look in the mirror and see not himself but Boris Nikolaevich Yeltsin.”

The opposite happened. Much of what Mr Putin did in his first term was aimed at dismantling Mr Yeltsin's legacy. Just before his virtually unopposed re-election this March, he dismissed Mikhail Kasyanov, the prime minister and the last of Mr Yeltsin's (and the oligarchs') senior allies, making his own position more unassailable than ever. Facing his second and final term (unless a servile parliament changes the constitution), he has as much freedom as any post-Soviet leader will ever have to do what he wants—whatever that may be.

That has brought the question, “Who is Mr Putin?”, which raged for the first couple of years of his

presidency, to the fore again. His background as a mid-level KGB agent in East Germany, followed after 1991 by a stint as deputy mayor of St Petersburg (where he was responsible for the city's foreign relations and economic development), shows in his policies: he tends to trust his fellow *siloviki*, men from the security services, yet he clearly understands the need for Russia to overcome the legacy of Soviet economic planning and rethink its position in the world.

Those who know him describe him as a “mirror-man”, often seeming to adopt his interlocutors' ideas and even speech, which adds to the confusion. Human-rights activists and army generals alike come away feeling that he is on their side. He keeps all the forces in his government in balance, creating endless debates about whom he favours, and indeed whether he is the puppet-master or the puppet. He is also good at shifting blame on to his officials, so he remains hugely popular even if his policies are not.

Nonetheless, over the past four years his main goal has become clearer. On the face of it, it is a simple and reasonable one. He wants Russia to be a strong country: economically powerful, politically stable and internationally respected. What is in dispute is what those goals mean to him, the methods he uses to achieve them, and whether he is as powerful as he seems.

This survey looks back at Mr Putin's first term and forward to the second. It tries to reconcile the optimistic and pessimistic views by showing that both contain much truth, and both are necessary to understand today's Russia. Economic liberalism and political illiberalism are complementary parts of Mr Putin's strategy, but his contribution to both is often exaggerated. Russia's new-found prosperity is fragile and will require deep and difficult reforms to sustain. At the same time the shrinkage of freedoms is less clear-cut than it seems, and not always the result of orders from the top.

A case neither open nor shut

What is clear is that an open economy and a closed political system make uneasy bedfellows. The overweening bureaucracy is harming business, and not just that of power-hungry magnates like Mr Khodorkovsky, but of the little people building the foundations of Russia's new economy. Encouragingly, business is fighting back, and citizens, increasingly deprived of a political voice at the top, are beginning to build democracy from the bottom up.

But that will take time. The past 13 years have discredited democracy for Russians. The way to avoid both disappointment and confusion is to abandon the assumptions of the 1990s, accept that Russia is on a path of its own for now, and try to understand where that path leads.

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Taming the robber barons

May 20th 2004
From The Economist print edition

The oligarchs are keeping their heads down, but out of fear, not respect for the law

AP

Riches won't buy you freedom

THE tussles between the inscrutable Kremlin and a small band of obscenely rich men are far removed from the lives of ordinary Russians. But nothing typifies the contradictions of Mr Putin's presidency like the saga of Mikhail Khodorkovsky. It embodies the tension between the rule of power and the rule of law, exemplifies the opacity of Russian decision-making, and splits opinion—especially western opinion—about Mr Putin's real motives right down the middle.

Like other “oligarchs”, Mr Khodorkovsky, already rich after some clever wheeling and dealing in the crumbling Soviet Union, became super-rich thanks to the pact between business and the Kremlin to ward off a Communist comeback in the 1996 presidential election. In return for supporting Boris Yeltsin, he was allowed to buy control of his oil company, Yukos, for $309m in 1995. His own bank, Menatep, ran the auction. Like his fellow magnates, he expanded his business empire by dealing ruthlessly with business partners, creditors and minority shareholders.

When Mr Putin took office, two media barons, Vladimir Gusinsky and Boris Berezovsky, realised that he might break their hold on power, and began using their national television stations to attack him. In July 2000 he called a meeting with 20 other oligarchs to set the rules: they could keep what they already had, but in future must stick to the law and stay out of politics. Soon a series of legal investigations had stripped Messrs Gusinsky and Berezovsky of their main assets (though they kept sizeable fortunes) and chased them into exile. Several others faced criminal cases too, which were later quietly dropped when they toed the line.

Mr Khodorkovsky seemed to understand the new rules. He was also the first to grasp that, with the era of asset-grabbing gone, it would pay to turn Yukos into a transparent company run the western way. Investors rewarded him. At its peak last year, his stake in Yukos was worth 106 times more than what he had paid eight years earlier.

But last July Platon Lebedev, one of Mr Khodorkovsky's closest partners, was arrested for embezzlement in the acquisition of Apatit, a fertiliser company, in the early 1990s. A wave of investigations followed, looking into everything from Yukos's tax payments to its part-privatisation to its links to unsolved murders. In October, in a dramatic dawn raid on his private jet, Mr Khodorkovsky himself was arrested. Hehas been in jail awaiting trial ever since.

For months, even the best-connected were baffled. Each scrap of information bred new theories and shook the financial markets. Had Mr Khodorkovsky broken Mr Putin's ban by openly funding political parties or pro-democracy projects through his philanthropic Open Russia Foundation? Had he annoyed the president by campaigning too hard for an end to the state pipeline monopoly, or for a pipeline from Siberia to China when the government was in talks with Japan? Did the government want to prevent Yukos from being bought by a foreign oil firm, or from buying a Russian firm, Sibneft, and becoming too big? Was it because Mr Khodorkovsky, at a public meeting with Mr Putin, had implicitly accused senior officials of corruption? Had Mr Putin himself sanctioned the attack on Yukos, or were the shadowy *siloviki*, his henchmen from the security services, pulling his strings? If so, would they stop there, or was it part of a wider campaign against the oligarchs and Yeltsinites? Mr Putin always insisted that the prosecutors were independent and merely looking into alleged crimes. But if they were, why not investigate every single oligarch in the country?

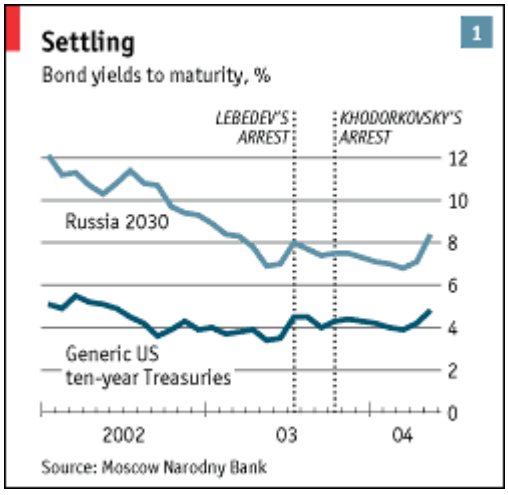
Since then, a sort of consensus has emerged. Though Mr Khodorkovsky's agitation against pipelines and corruption had doubtless made him enemies, probably Yukos's greatest crime, explains Chris Weafer, chief strategist at Alfa-Bank in Moscow, was to fall foul of Mr Putin's long-term plan. During his first term the president had allowed the oil firms to ride the wave of high oil prices and make huge profits, thanks to transfer pricing and offshore tax havens. This had helped kick-start the economy. He would use his second term to wean it off oil. Thus, early last year, ministers began talking of raising taxes on the natural-resources companies and closing loopholes. The extra revenues would allow them to help other businesses, for instance by lowering other taxes and investing in infrastructure.

Yukos was not the only firm to oppose the tax changes. But as Alexei Kudrin, the finance minister, told a Russian magazine, *Kompania*, in February, in the only admission from on high that the case was political: "Other companies' lobbyists did not behave so aggressively." Yukos's people, he said, "came to me and talked directly about laws that didn't suit them: 'Alexei Leonidovich, we won't let you get your decisions through the Duma, no matter what it costs us'." They meant it. At a reading of the tax bill in June last year, even the Communists, usually no friends of the oligarchs, voted against it. That must have been the final straw. Mr Lebedev was arrested soon after.

Paying the price

So, Mr Kudrin said, the Yukos affair was "inevitable, not in the personal sense, but in the sense of a clarification of the rules of the game." The new laws were bound to meet opposition; because he led it and refused to bend, Mr Khodorkovsky was the one who paid the price. After his arrest, Mr Putin told a meeting of business leaders that "the business community could also put some effort into developing a system of new social guarantees" and "help support the transformations that have now begun in the armed forces, the housing and utilities sector, health and education."

As in 2000, other oligarchs were quick to pay fealty. Earlier this year Vladimir Potanin, the head of the Interros group, demonstratively took his investment plans to the Kremlin before showing them to shareholders. Lukoil, one of Yukos's rivals, said it would voluntarily keep clear of tax loopholes, even though they were not illegal. Viktor Vekselberg of TNK-BP, another oil firm, bought a Fabergé egg collection that had belonged to Tsar Nicholas II from the Forbes family in America, calling it "a once-in-a-lifetime chance to give back to my country one of its most revered treasures." Meanwhile, Mr Khodorkovsky sits in jail, sending out windy manifestos that nobody takes seriously. Yukos, some think, faces partial renationalisation, but the markets are as upbeat about Russia as ever (see chart 1). And there has been no more talk of private pipelines.



So all is well? Not really. The rules of the game remain hazy. There is talk of a list of 15 top businessmen who risk the same fate as Mr Khodorkovsky unless they show particular devotion. Firms are scrambling to implement whatever they think Mr Putin's idea of "social guarantees" might be: Pension schemes? Charity work? Investing where they are told to? Closing their offshore bank accounts? Firms now feature their philanthropic activities prominently on their websites.

There is no doubt that Mr Putin is in charge—for now. But it all sounds suspiciously like a re-run of July 2000, when he promised to support businesses "who act in the state's interests" and they, in turn, praised his "honesty and goodwill". It may only be a matter of time before another magnate gets bold or foolish enough to provoke another clash. They still have clout: by one estimate, as many as 40% of the Duma's deputies are ex-employees or have other links to oligarchic firms.

These problems will arise because Mr Putin has deliberately avoided introducing something he claims to hold dear: the rule of law. When the "robber barons" who built the foundations of American industry got too powerful at the end of the 19th century, the government passed antitrust laws to break up the barons' monopolies, and enforced those laws evenly and openly. Mr Putin prefers to limit the influence of business on politics by wielding arbitrary power. That is not so surprising: laws might be weak, whereas a sword of Damocles hanging over every head is highly effective. Feudalism works. But it is also easily abused.

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Power to the power people

May 20th 2004
From The Economist print edition

A spider's web of hidden controls

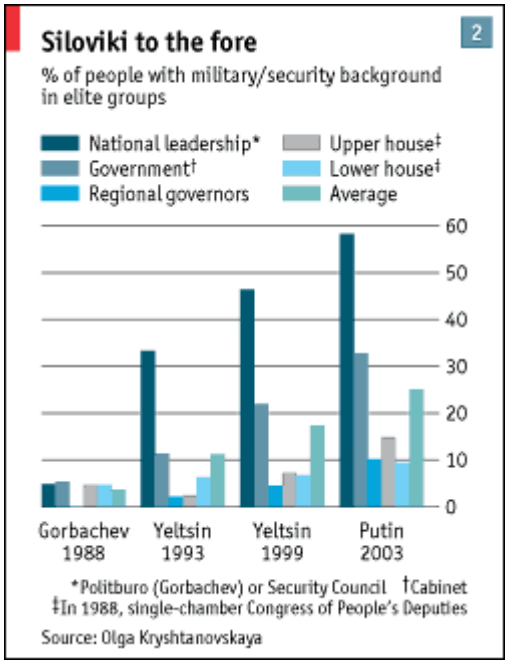
They're out of newspapers. Shall I get a TV station instead?

"IT'S a typical post-revolutionary situation," says Georgy Satarov, a former aide to Boris Yeltsin who now runs INDEM, a think-tank. "Attempts to strengthen the state, using the rubble of the previous state. After the French revolution overthrew the aristocracy, Napoleon created a new aristocracy. The same thing is happening here."

By "aristocracy", though, Mr Satarov does not mean the oligarchs. He is talking of the new elite: the *siloviki*, loosely translatable as "power people", to whom Russians refer by tapping an imaginary epaulette on their shoulders; the men from whose ranks Mr Putin comes.

The *siloviki* infest the nightmares of those who fear that Russia is returning to authoritarianism. Like horror-film zombies, they seem to proliferate. According to Olga Kryshtanovskaya, a sociologist at the Centre for the Study of the Elites at the Russian Academy of Sciences, people with a military, intelligence or law-enforcement background make up around three-quarters of Mr Putin's top officials, as against just 5% of Mikhail Gorbachev's Politburo. They occupy more than a third of the posts in the top three levels of government, and make up 70% of the staff of Mr Putin's seven federal envoys or "super-governors". Mrs Kryshtanovskaya classifies Mikhail Fradkov, the new prime minister, as a "hidden *silovik*": there are tell-tale hints of some KGB training in his youth (a brief gap in his biography, an early diplomatic post), and he was a protégé of Sergei Ivanov, Mr Putin's defence minister.

As a group, Mrs Kryshtanovskaya says, *siloviki* are "the part of society that lost out the most from democratisation. They were privileged in Soviet times, they were above the law...They want a return to 'fairness', which in their eyes means a strong state that gives them these privileges." Leading *siloviki* have their own powerful business ties, including to state-owned arms and oil firms.



Yet to raise the alarm about the *siloviki* themselves partly misses the point. First, they are not a united group with common goals. In the old days, those in foreign intelligence considered themselves an elite and felt "contempt for what they saw as the idiots who ran internal security," says a senior western diplomat. (Mr Putin, who served in the KGB in East Germany, straddled the two.) Thanks to their contact with the West, they were often the most sophisticated members of the Soviet *nomenklatura*. Second, it was Mr Yeltsin, not Mr Putin, who began appointing *siloviki* at all levels (see chart 2), perhaps because they were often more disciplined and professional than other bureaucrats.

Third, last year's scare of a *silovik*-led takeover of power owes a great deal to Yukos. When the company faced the Kremlin's wrath, it tried to win support, especially in the West, by circulating scary tales about its run-in with two of Mr Putin's *silovik* sidekicks, Victor Ivanov and Igor Sechin. But it is now clear that the oil company had annoyed the president and his economic team every bit as much.

And fourth, though he has put *siloviki* in charge of some of the

important ministries—such as defence and internal affairs—Mr Putin has kept economic policy under the control of liberal economists. In the cabinet reshuffle he went one further by replacing the six deputy prime ministers of old with a single one, Alexander Zhukov, a respected economist, who is to oversee reform. Cabinet purges have been aimed at those loyal to the oligarchs, rather than specifically those who oppose the *siloviki*. Mr Fradkov seems to have been picked not so much for his possible KGB ties as for his obedience, efficiency and—allowing that Mr Putin wants Russia to become a member of the World Trade Organisation—long experience of foreign-trade issues. Even in his presidential administration, Mr Putin has kept counterweights to Messrs Ivanov and Sechin.

There are real concerns about the *siloviki*, though. One is that in their strongholds, they are now as powerful and unaccountable as in Soviet days. Historical researchers complain that access to KGB and Communist Party archives is closing up again. Meddlesome journalists and newspapers can expect raids, and worse, from the FSB, the KGB's successor. The threat of terrorism is used to justify everything from more document checks on the street to trials being held *in camera*.

More sinister still, there has never been a public explanation of how a large band of Chechen terrorists managed to take control of Moscow's Dubrovka theatre in October 2002, nor for the deaths of at least 120 hostages—some think many more—after special forces gassed and then stormed the building. The Duma commission investigating claims of FSB involvement in a series of apartment-block bombings in 1999, which were officially blamed on Chechen terrorists, has suffered a suspicious number of misfortunes. Last year one of its members was murdered, a second died mysteriously of food poisoning, and a third was severely beaten up. Mikhail Trepashkin, an ex-FSB agent and lawyer representing two of the bombings' victims, who was planning to voice his own suspicions about the FSB's role at the bombers' trial last autumn, was jailed a week before the trial started.

Big Brother is watching

What is also worrying many people is that the whole federal apparatus has become bigger and more intrusive. Mr Yeltsin had told the 89 regional governors to “take all the power they could”. That led to chaos. Mr Putin appointed inspectors to each region and grouped them into seven federal districts, where his envoys have helped redraft a large number of regional laws that contradicted federal ones, and sorted out jurisdictions.

Most other law-enforcement agencies have opened regional offices too. Regional police chiefs and prosecutors, who used to be appointed and promoted locally and were often in corrupt cahoots with local bosses, are now appointed by the central government and rotated from one region to the next. According to Nikolai Petrov at the Carnegie Centre in Moscow, three-quarters of them have been replaced or moved since Mr Putin took office.

The presidential administration has also opened over 2,000 “public bureaus” for citizens to file complaints or seek advice. The administration itself has swelled almost into a parallel government, like the Central Committee of the old Communist Party; a recent “cut” after the cabinet reshuffle turned out to be largely cosmetic.

Some order after the chaos of the Yeltsin years was certainly needed. But the new structures, says Mr Petrov, do more: they form an extensive intelligence-gathering network, which comes into its own at critical times such as elections. The public bureaus, which local businesses are invited to fund as part of their “philanthropic spending”, collect information at the grassroots level, and the federal-district offices keep a close watch on the local bureaucracy. And although the regional law-enforcement bosses may no longer serve local masters, “that does not necessarily reduce corruption,” says Mr Petrov. “It simply redirects it.”

Thus, he says, Mr Putin's weakening of democracy “is not a plan, but a logic: it's a side-effect of the strengthening of the federal centre.” But side-effects sometimes take centre stage. In several instances, the Kremlin has blocked governors' re-election or installed its own appointees. In October Mr Putin, blithely ignoring a law that bans senior officials from electioneering, openly supported Valentina Matvienko, his chosen candidate for the governorship of St Petersburg. She won, but nearly three-quarters of the voters showed their disgust by staying away.

Freedom of speech—as long as it's quiet

Some of the heaviest criticism of Mr Putin concerns press freedom. Mr Gusinsky's and Mr Berezovsky's television networks, NTV and ORT, were the first to be taken over. NTV itself, under its new government-appointed manager, Boris Jordan, was still relatively independent. But late in 2002 it came under fire for imperilling the Dubrovka hostage rescue. The networks had promised to get clearance before airing footage of special forces storming the theatre in order to keep the terrorists in the dark. NTV had supposedly broken the promise. Mr Jordan insisted that its pictures went out only after the rescue ended, but was ousted soon after.

But the real picture is rarely clear-cut. The journalists at NTV and ORT are under state orders now, but they were hardly “free” under their old bosses, who had used their channels to engineer Mr Yeltsin's 1996 election victory and later to attack Mr Putin. Mr Jordan's departure, some at NTV think, may be mostly due to his refusal to sign a deal with Video International, a powerful advertising company formerly run by Mikhail Lesin, who later became press minister.

Moreover, smaller media outlets are thriving, even if owned by oligarchs. Mr Khodorkovsky may lose Yukos, but he still controls TV2 in Tomsk, one of the best and most independent—not least of its owner—regional stations. He also bought and revived a former dissident newspaper, *Moskovskie Novosti*, putting Yevgeny Kiselyov, the original editorial chief at NTV, in charge of it. Mikhail Fridman's Alfa-Group has a stake in a national entertainment channel, STS. Mr Berezovsky controls the feisty *Kommersant*, a leading Moscow business daily, and three other papers often critical of the government.

On the other hand, Vladimir Potanin's papers, *Izvestia* and *Komsomolskaya Pravda*, have bigger readerships and are much more loyal to the Kremlin. “There is freedom of speech,” says Rustam Arifdzhanov, who has just started up his own media group catering for ethnic minorities, “as long as it's not a threat to the authorities. Russia will have just as much freedom of speech as it needs.”

But who decides how much it needs? As in his dealings with the oligarchs, Mr Putin prefers wielding arbitrary power over the media to having clear laws. Clearly he distrusts media owners. He may tolerate some press freedom now, but no one knows for how long.

“He sees the media as an instrument,” says Alexei Venediktov, editor-in-chief of the fiercely independent *Ekho Moskvy* radio station, who has often discussed the media with Mr Putin and those around him. “In 2000, he met with all the chief editors and told us, ‘You ought to help me. These reforms are unpopular and hard ...After that you can do what you want, but for now you're working for the good of Russia.' I said to him, ‘Our job isn't to help or not, it's to report!' He said that wasn't enough.” Mr Venediktov thinks his station, which is majority-owned by the state firm Gazprom but has a charter guaranteeing its independence, will be fine as long as things go well and Mr Putin is popular. “Where else am I going to hear the news?” one minister is said to have demanded. But if the honeymoon ends and *Ekho Moskvy* becomes the echo of public discontent, the station may find itself in trouble.

Lacking a real lobby, the press is vulnerable to legal attacks. One such was a law, drafted before the Dubrovka hostage crisis and rammed through the Duma after it, that clamps down on reporting in “emergency situations”. Most free countries have such laws, but in Russia the authorities have enormous discretion over what counts as an emergency. A second was a law passed last year that banned the media from publishing comments on candidates for election. It was overturned by the constitutional court soon afterwards, but by that time, says Mr Venediktov, the law had already been used to launch cases against 17 regional media outlets.

The other thing that makes the press vulnerable is the small size of the advertising market. Video International's dominance therefore gives it great power, as TV stations have found to their cost. Paid-for articles are common (a full-page story in a leading Moscow daily commands $20,000, according to one advertising-agency manager).

In the regions things are even worse: many publications are loss-making arms of other businesses whose owners may use them for their own ends. If the governor does not like what a paper prints, he may order a wave of tax inspections on its owner's shops or make life hard for it at the regional press that still prints most local publications. Local journalists who investigate corruption are sometimes murdered with impunity.

The Samara region, an industrial hub on the banks of the Volga, has over 500 registered media, says Andrei Gavriushenko, the co-editor of *Delo*, a business magazine. Yet even there, in one of the most prosperous regions outside Moscow and St Petersburg, the company that owns *Delo* and a handful of sister publications is one of only three publishing houses not owned by another business. “All our

‘independent' Russian media are very dependent,” Mr Gavriushenko smiles.

Now journalists are worried about a new press law on which an “industrial committee”, made up mostly of media owners, has been working since the Dubrovka crisis. Mr Venediktov, who sits on the committee, says the law defines the press's responsibilities to its owners but says nothing about its responsibilities to the public—another way of making it “just an instrument.”

Passing bad laws, or good laws with bad details, or good laws that are badly implemented, are all risks of Mr Putin's system. The intentions may be excellent, but what of the results? This matters most when it comes to his main project: making Russians better off.

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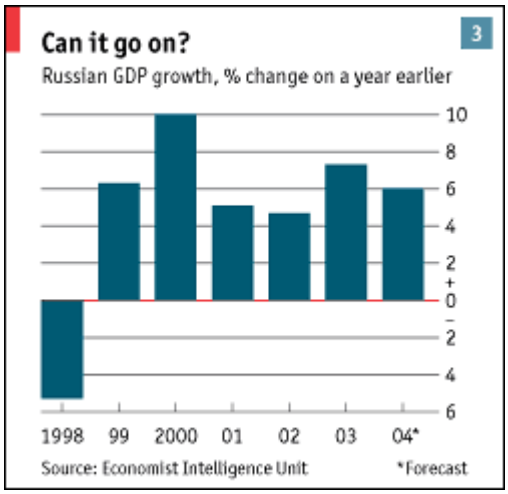
Too much oil in the works

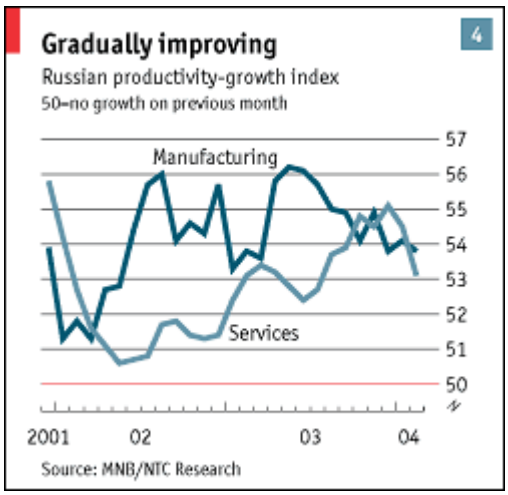
May 20th 2004
From The Economist print edition

Russia is booming, but for how long?

“IN A decade, we have at least to double the country's gross domestic product.” In his speech to parliament a year ago, the usually cautious Mr Putin shook the entire government out of its complacency. Never mind the exact target: can he deliver consistent growth at all?



So far things look better than ever. GDP growth breached 7% last year (see chart 3) and seems set to do almost as well this year. And unlike the boom before the 1998 default, which was driven by a fixed exchange rate and a mountain of government debt, this one looks real. The government's finances are under firm control, and foreign-currency reserves at the end of April stood at nearly $79 billion. Moody's, a rating agency, promoted Russian debt to investment grade last October. Fixed investment grew by over 12% in 2003, which shows that companies are now modernising and expanding. Productivity is growing steadily (see chart 4).



As consumption figures testify, ordinary Russians are feeling the benefits. Whereas only a few years ago life outside the biggest cities was unremittingly bleak, now it is rare to find a regional capital without a profusion of smart new shops and restaurants. And most of the people spending money there are not bandits or corrupt officials, but a genuine middle class making an honest (by Russian standards, anyway) living. The number of Russians classified as “poor” has fallen by a third in the past four years. Even the demographic squeeze that alcoholism, poverty and the miserable prospects for the future have imposed since the end of the Soviet Union seems to be easing slightly. Last year, for the first time since 1998, the alarming natural decline in the population—some 900,000 per year—began to slow.

People are beginning to demand normal-country things like bank loans, credit cards and mortgages, which have only recently appeared in Russia for the first time. Companies are discovering that a population of 145m spread over 11 time-zones is a terrific market for mail order and online shopping. Though their salaries are low by comparison with the West, Russians save little, pay low taxes, tend to own not rent their homes and love gadgets and fashions, making them a goldmine for a businessman with daring and imagination. Stephan Dertnig of the Boston Consulting Group, which is bursting with new clients, estimates that a mid-sized firm which would make a 10% return on sales in the West could expect 25% in Russia.

What reforms?

Yet little of this is thanks to reforms. Although there have been some, most notably one to simplify and cut taxes (so that more people are now paying them), Mr Putin's main contribution has been to create, by comparison with his disorderly predecessor, a feeling of stability that allows people and businesses to think ahead.

Moreover, what drove growth in his first couple of years was the post-crash recovery, and much of what

drives it now is an oil boom. According to a calculation by the World Bank last August, had oil prices not been rising, the 7.2% annual growth rate in the first half of 2003 would have been 4.2%; solid, but not the stuff of economic miracles.

Russia's energy dependence is pernicious in many other ways too. The World Bank estimates that the oil and gas sector, which employs less than 1% of the workforce, accounts not for 9% of GDP, as the official figures state, but for nearer 25%. The official statistics are distorted by transfer pricing, a tax dodge whereby oil firms sell cheaply to trading companies they control, which sell on at market prices. This has cost the federal government billions of dollars in potential revenues. Though awash with profits, the oil firms are lazy; they tend to invest in squeezing the most out of their current oilfields, rather than in exploring new ones. Yet many oil towns are miserable places where most businesses are controlled by the oil company. With little else to entertain them, workers often spend their pay packets on drugs and prostitutes, turning the towns into hotspots of HIV infection.

Even so, thanks to high oil prices, the federal government has run budget surpluses. Isn't this good? No: the money all too often bails out regional governments, which use it as a quick fix for local unemployment by creating public-sector jobs, when it would be better spent on building infrastructure or lowering taxes to help the private sector.

Nor is the oil cash an unmixed blessing for the economy (see chart 5). Combined with a weak dollar, it has driven up the rouble much faster than the central bank would like, leading some economists to argue that Russia still risks catching “Dutch disease”: a strong currency, rising imports, less competitive exports. Banks are trying to lend as much as they can, so there might be a small wave of defaults in two or three years. But the banking system is too shallow to absorb all the cash washing around. Top officials have started flagging up the risk of an asset-price bubble.

The surplus cash, along with flight capital returning from abroad, is fuelling what Roland Nash at Renaissance Capital, a Moscow investment bank, describes as “the mother of all shopping sprees” by the big conglomerates, often compared to Korea's overgrown *chaebol*; their rush of acquisitions is leaving “small islands of industry in a sea of chaebolised assets”. Though these firms are driving a much-needed consolidation of the leftovers of Soviet industry, they are—according to the World Bank—no more efficiently run than other businesses, and their market power and ability to wring favours from regional governments is a threat to smaller firms.

Oil prices may stay high for a while if the turmoil in the Middle East continues. But when they fall, growth will stutter, unless other parts of the economy have become stronger by then. Large swathes of Soviet-era industry have failed to restructure, and now face a growing challenge from imports as Russians' incomes rise and their tastes change. Small businesses, though growing fast, still account for a mere 12% of GDP, as against 30-70% in developed market economies. For sustainable long-term growth, these businesses need a better climate. This is where reform starts to matter.

Mr Putin evidently realises this. Having spent his first term making sure he was firmly in control, he has ambitious plans for the second. “There is a theme that the first term was one of preparation, consolidating control and removing the legacies of the Yeltsin era, while the second one is of implementation,” says Chris Weafer at Alfa-Bank. “The stockmarket is currently pricing in that this government will be able to do everything it has promised.”

Those promises include:

•Separating out the 1,000-plus banks that act as little more than pocket banks for companies from the few dozen that do retail banking and lending, and regulating the second group better.

•Making the big natural monopolies more market-oriented. UES, the state electricity firm, is already on the way to being broken up. Gazprom, the gas behemoth, probably will not be, but other gas suppliers

will get access to its pipelines, there will be more private investment in its projects, and domestic gas-price subsidies may be cut.

•Investing in starved social infrastructure, notably housing, health and education, and modernising the way they are managed (for example, by expanding the use of health insurance and sorting out responsibility for the decaying communal parts of blocks of flats).

•Making the courts more efficient, more transparent and less corrupt, which is essential to allow small businesses to defend themselves, and further reducing the bureaucracy those businesses face.

•Other economic reforms, such as anti-monopoly measures, to allow Russia to join the WTO. Entry has been delayed many times, but is currently set for the autumn of next year, in time for Russia's chairmanship of the G8 in 2006.

•An overhaul of the armed forces, shrinking them and ending conscription in favour of a professional army.

•An administrative reform. A commission has identified some 5,000 functions of government, 1,000 of which it considers superfluous. These will be eliminated, and a fifth of the 2m-plus bureaucrats in central government will be fired; what the rest must and must not do will be tightly defined and put in writing.

All very fine-looking. Having reined in the natural-resources firms—a new windfall tax could bring in as much as an extra $3 billion next year—the government should have plenty of cash with which to implement these reforms. It has also hinted that it will stop running budget surpluses. Already this year, tax cuts worth $10 billion should give businesses a buzz. But there are problems.

One is that all this depends on oil prices staying high enough for long enough. True, they have a long way to fall before reaching the government's break-even level of $20 a barrel. And if this year's price predictions are right, says Mr Zhukov, the deputy prime minister, the excess will leave 500 billion roubles in the oil stabilisation fund, enough to maintain current spending for two years even if the oil price drops.

But the ocean of petrodollars is not merely drowning the economy; it seems to have put the government into a state of self-hypnosis. Ministers regularly repeat Mr Putin's mantra of doubling GDP in a decade, though that would take unbroken growth of 8% a year. When German Gref, the economy minister, said in a cabinet meeting in February that he would like to see poverty halved in three or four years, Mr Putin rebutted, “Don't be shy, say it: in three years this level will be achieved.” Shyly, Mr Gref replied, “We will do our best.” Within a few days he had increased his growth estimate for 2004.

Once again, with more feeling

The second problem is that Mr Putin has tried some of these reforms already, and his record is not good. There have been first stabs at such things as bank deposit insurance to help private banks compete against the state-owned near-monopolist, Sberbank; private ownership of agricultural land; less bureaucracy and better protection for small companies; and, as in many western countries, the difficult move from a pay-as-you-go pension system to a funded one. But all too often the implementation has been a fiasco. Workers can now invest their retirement savings with private fund-management companies instead of the state pension fund, for instance; but they were given so little information that only 2% chose to do so.

Workers at collective farms, who are entitled to a share of the farm's land, can now turn it into private property. But the law left it up to regional governments to set conditions, such as the minimum size of a private plot; some have chosen sizes as large as 200 or 300 hectares, which favours the farms' existing managers and forces the farm workers to band together in large, unwieldy groups if they want to strike out on their own. Military reform has been in the works since Mr Putin appointed a civilian *silovik*, Sergei Ivanov, as defence minister, but to the president's evident frustration it has more or less ground to a halt.

To many observers, any progress at all is a miracle. The land

reform, says Ksenia Yudaeva, an economist at the Carnegie Centre in Moscow, “was one step forward and two steps back, but nobody believed that our state could bring the concept of private property to agricultural land.” Richard Hainsworth, a banking analyst for Renaissance Capital, says the bank reform, though it was held up and then watered down, “is going in the right direction, and it would be very difficult for someone to come in and do better.” Now that government, parliament and business all obey him, Mr Putin should, goes the thinking, be able to push reforms through faster.

But—and this is the third problem—faster may not mean better. Bad laws can now be rammed through as easily as good ones. And the reforms for the second term are more complex than for the first, so the gap between laws and implementation could grow even wider. To make them work requires an effective bureaucracy.

That is why the administrative reform matters so much. It has been years in the making. Mikhail Kasyanov, the prime minister until February, had persistently held it up, one possible reason why Mr Putin fired him. A first step towards it was a restructuring of the government in March, which notionally created separate agencies in each sphere for policymaking, implementation and regulation.

Do I look rich in this?

But so far it looks like little more than a reshuffle. Nobody has been fired. This may just be the cautious Mr Putin's usual strategy: he moves people sideways instead of ditching them. But the bureaucracy, immortalised in 19th-century Russian literature, is famous for its ability to frustrate its masters as much as to enrage the ordinary citizen. Nobody has yet explained precisely how this hydra, which under Mr Putin has grown even bigger, can be made to cut off so many of its own heads. And if it does not, the citizens will suffer.

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Watch your back

May 20th 2004
From The Economist print edition

Running a small business is far from straightforward

AP

Hallo, we're from the shareholders' association

WHEN Aleksei Panteliushin turned up at Plutos, his sausage factory in northern Moscow, one frosty morning last February, he found a gang of robust young men guarding the entrance as blacksmiths replaced the glass door with a steel one and reinforced the bars on the windows. He called the police. They went in, stayed for ten minutes—and left again. He called the internal security agency, the FSB. The same thing happened. He called his lawyer, who tried to go in and was told that if he persisted, they would “rip his head off”. When Mr Panteliushin at last gained entry, together with a senior police officer, three of the goons introduced themselves as “Stanislav”, “Alexander” and “Sergei”. They said they were Plutos's new owners, and flourished a document from the justice ministry to prove it.

Shortly afterwards, they invited Mr Panteliushin to a meeting and offered to buy his share in the company at well below market value. They had already got his employees to sell them their shares far too cheaply, on pain of being fired. Mr Panteliushin declined. Instead he wrote a statement, collected supporting signatures from some 40 employees, and—with the thugs openly tailing his car—filed the case with every law-enforcement agency he could think of.

He was told that the authorities did not get involved in “ownership disputes”. When he took his woes to his local tax officials, who at least were friendly, thanks to his annual Christmas gifts of sausages, they shrugged and showed him a sheaf of 15 or 20 similar complaints in the same district. A journalist recommended the Economic Security Commission of the Moscow mayor's office, where an official listened to the tale. The next day Mr Panteliushin got a call from a non-governmental organisation called “Protection of Shareholders' Rights”. This turned out to consist of a pair of affable young men with no address on their business cards, who said they knew those concerned and offered to “mediate”.

They were also kind enough to explain how the business had been appropriated. In November, a fictitious shareholder meeting had been called. It appointed a new factory director, who “sold” the factory to another firm, which sold it on again, re-registering the ownership each time. This morass of paperwork would make any legal challenge enormously complex. (It did not help that Mr Panteliushin had kept his shareholder register in the company safe, allowing the bandits to destroy the evidence.)

Not that the “takeover” itself had been a snip: what with bribes, hire of thugs, share buy-outs and lawyers' fees, it had cost some $300,000. The new owners, the mediators said, were now offering to sell the factory back for $6m, several times what Mr Panteliushin says it was worth.

Are such tales getting more common, or less? That is hard to answer. They were two a penny in the early 1990s, when Russia still lacked most of the legal framework for protecting private property. Today the laws are in place; they merely do not work.

Such raids happen, says Rinat Sagdiev, a business journalist at *Vedomosti*, a Moscow business daily, when established businessmen have money and want to expand quickly into other sectors. Typically they target factories dating from the Soviet era, which are likely to be both inefficient and poorly defended. “Stanislav” told Mr Panteliushin later that he had carried out about ten similar raids. Other takeover methods, says Mr Sagdiev, include using a shareholder dispute to grab some of the shares, getting a compliant official appointed as a receiver when a company goes bankrupt (some go broke deliberately to avoid taxes), or phoning with a bomb threat and sending in the new owners disguised as a sapper team.

If Mr Sagdiev is right, then Mr Panteliushin's woes may be yet another by-product of the spare oil cash washing around the economy. But the fact that the bandits often get away with such raids also highlights the unaccountability of officials.

Owners may fight back if they have powerful connections. When Ilim Pulp, Russia's largest forestry company, in 2002 faced a takeover by Basic Element, a big aluminium and industrial conglomerate, Mr Putin reportedly intervened. For those a little lower down the food chain, calling in a barrage of tax and health inspections may incline the new owners to negotiate. Small fry, however, are powerless. Mr Panteliushin says various law-enforcement officials quoted him between $200,000 and $500,000 to get involved, but with no guarantee of success, because his opponents might pay more.

Even if he could muster the paperwork and the nerve needed to go to court, the outcome again would probably depend on who had the bigger bank balance. On the overnight train to the city of Penza, a young lawyer has relaxed enough after three toasts to explain why he joined the profession: “In business disputes we sometimes have to be intermediaries. I go to a judge and say, ‘I really need to win this case.' He says, let's say, 100,000 roubles. I go to my client and tell him 130,000.” He shrugs and raises his glass again.

The law is an ass

“The judicial system is 100% corruptible,” agrees Bernie Sucher at Alfa-Capital. “There isn't a single case that can't be influenced by money.” And yet Mr Sucher is one of the biggest optimists about Russia, pointing out that business is flourishing, even if the rules sometimes depend on things other than the law. Richard Wallace, the director of the Russo-British Chamber of Commerce, takes a similar view. “You need to do your homework, build up contacts, not go in blind. It's a question of knowing how to operate and accepting that the rules are different.”

British Petroleum is a good example: having suffered all manner of dirty tricks in a deal with the Tyumen Oil Company (TNK) in 1997, it overcame the bad blood and bought half of TNK for $6.75 billion last year, the biggest foreign buy-out to date. To people like Mr Sucher, that deal, completed at the height of the scandal over Yukos, was a sign that those who know the hidden rules will always be fine.

The problem with informal rules is that nobody tells you when they change. Mr Panteliushin broke a rule that he mistakenly thought had been abolished: that businesses need a *krysha*, or “roof”—a protector. “We used to have a *krysha*—some local bandits, like everyone did. Gradually the bandits went to jail, and we came under the wing of the authorities. That turned out to be a big mistake.”

However, Sharon Tennison, who runs the Centre for Citizen Initiatives, an American non-profit body that trains Russian entrepreneurs, thinks that cases like this have become rarer. “The criminal element has pretty much gone from small and medium-sized business,” she says. “Today it's the officials, the fire inspectors, the tax inspectors, the mayors and so on who are on the take, and the take is getting as high as it was back when the criminals were holding everyone up.”

The government has passed laws to let businesses breathe easier. A three-stage survey in 2001 and 2002 by the Centre for Economic and Financial Research in Moscow found encouraging signs: firms were being subjected to fewer inspections, licences were getting easier and cheaper to obtain, and corruption was less rife; by the time of the second stage of the survey, “for the first time in Russia's transition history...firms started to perceive competition to be a more serious problem than government regulations.” But in the third round the improvements had slowed. Laws such as the one establishing a “one-stop-shop” registration for new firms, admits Andrei Sharonov, a deputy economy minister, are still largely unimplemented.

Yet Mrs Tennison is an unshakable optimist too. Over 15 years, her organisation has brought some 5,000 businesspeople from Russia's regions to America for training, usually at their own expense. At a recent event in Washington, DC, a group of them met experts from 16 countries to talk about methods of tackling corruption. Back in Moscow, they passed on their ideas to Russian officials, including Mr Putin's economic adviser, Andrei Illarionov.

They go home, she says, determined to change things. In the city of Volgograd, local entrepreneurs banded together and called a strike to protest against an increase in local taxes. In Tula, a supermarket owner took a local fire inspector to court—with the quiet backing of the local FSB—after being forced to pay a $20,000 bribe for a permit. The local authorities tried to drown him with other inspections, but he

held out, and the inspector went to jail.

Such cases are encouraging, but still extremely rare. That is why everything hinges on Mr Putin's administrative reform. The best way to cut official corruption is to reduce both the number of officials and the number of laws and regulations they can twist. Businesses of the kind that don't need, say, sanitary checks or fire inspections suffer less. On a television show in Moscow after their visit to Washington, nearly a third of Mrs Tennison's alumni said that they never had to pay bribes at all.

And Mr Panteliushin? His only recourse has been to get his story told. After a local newspaper picked it up, the police started taking an interest again, and he learned that other companies that had been approached about buying his factory were backing off. At the time of writing, he and the bandits were waiting it out. Increasingly desperate to sell, they were phoning him for advice on making sausages, and offering to hire him back to run the business.

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Who needs democracy?

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The parliamentary sort is dead, and civil society is only just beginning to come alive

AP

The only opposition?

“I'LL tell you why we have no democracy,” says Boris Nemtsov, suddenly dropping his customary nonchalant swagger and looking serious. “We spilled too little blood for democracy.”

It is a bright January afternoon, a few weeks after the election that wiped Mr Nemtsov's liberal-democratic party, the Union of Right Forces (SPS), off the political map. Yabloko, the party of social democracy since the first Duma in 1993, was extinguished too. Both fell short of the 5% needed to form a Duma block. The pro-Kremlin United Russia got just over two-thirds of the seats, giving it total control. Two other Kremlin stooge parties, the long-running Liberal Democrats (nasty nationalists) and the newly created Motherland (slightly less nasty nationalists), both of which were formed to cater for hardline voters, shared the rest of the seats with the fading Communists, the only group that might conceivably count as an opposition.

The state-run media favoured United Russia; one channel showed, in full, Mr Putin's 29-minute speech to party activists on the eve of the campaign (itself of dubious legality, because he is not allowed to campaign). Regional leaders also pulled out all the stops, the most eager ones claiming turnouts 20-30% higher than the national average. There were reports of government employees being obliged to vote for the Kremlin's party.

That may have helped to keep the liberal parties below the 5% threshold, but their real problem is that nobody wanted to vote for them. “They are the ones to blame,” says Alexander Yakovlev, who as Mikhail Gorbachev's right-hand man helped engineer the end of the Soviet regime, “for not working on the creation of a social-democratic base, for not attracting those who should have been on their side—doctors, teachers, pensioners.”

Many members of SPS and Yabloko agree. For years they played elite-level politics. They often supported the government's economic reforms, so voters saw little to set them apart from those in power. Last year, some now think, the two parties could have tried to win over the growing middle class on issues such as private health care and education. Instead, they wasted their time and money attacking each other.

And, perhaps most damaging of all, voters associated them with oligarchs such as Mr Khodorkovsky, who openly financed both parties. With the Yukos affair unfolding in the months leading up to it, the Duma election became the voters' first chance to show their anger over the plunder of the 1990s. All the pro-Kremlin parties capitalised on Mr Khodorkovsky's arrest. Indeed, the fear of a new rise of nationalism, stirred by Motherland's and the Liberal Democrats' strong results, may be overblown. Their virulently

anti-oligarch line, with calls for heavy windfall taxes on the oil companies—an extreme version of current government policy—probably appealed more to voters than their slogan “Russia for Russians”.

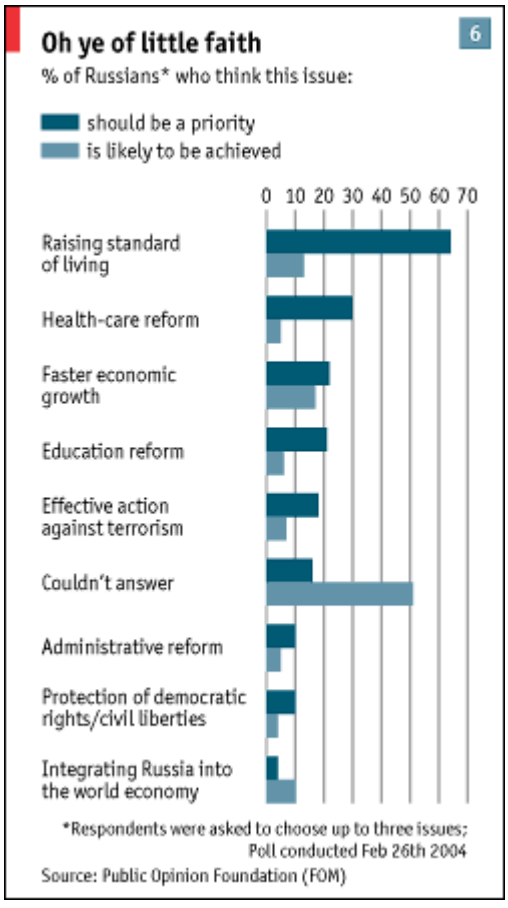
Liberals wring their hands. The elderly but still spry Mr Yakovlev, working doggedly to publish 60 volumes of secret Soviet records even as the FSB gradually cuts off his access to the archives, reminisces: “I, like a romantic, like a naif, fought for the creation of parliamentarianism, so that there would be alternatives, so that people could choose. I overestimated the readiness of people for that choice...But what happened after 1991 was never in my imagination.” Mr Nemtsov, equally romantically, argues that had more people died fighting for democracy, as they did in the American civil war or the French revolution, Russians would defend it harder now. “People don't look a gift democracy in the mouth,” he quips.

Parliamentary democracy, then, is dead. United Russia, a collection of political vehicles for various national and regional leaders, is by no means homogeneous, but its internal debates are held behind closed doors instead of on the floor of the Duma. The leaders of Yabloko and SPS are either in denial or in other jobs (including government ones). A “2008 Committee” has been formed to fight for clean elections next time round, but it is an elite talking-shop, not a popular movement.

Is the Kremlin cut off from the people? Not entirely. Ella Pamfilova, a former social-security minister who in 1994 broke with Boris Yeltsin, in 2002 became head of Mr Putin's human-rights commission, which also includes bona-fide human-rights activists. She thinks that in principle the president does believe in human rights, even press freedom.

Among her successes she cites a bill now being drafted to create a civilian inspection of prisons, draft amendments to restrict officials' power to mess businesses around, and better conditions for Chechen war refugees in tent camps. Other lobbyists have won such things as legislation against human trafficking. An American-Russian lobby group, the Transatlantic Partnership Against AIDS, is beginning to make political and business leaders aware how disastrous the disease could become. Mr Putin's nomination of Vladimir Lukin, one of Yabloko's top men, as his human-rights ombudsman is another good sign.

But this sort of “civil society” is a co-opted one, say other activists. “You can achieve certain concrete things,” explains Tatiana Lokshina of the Moscow-Helsinki Group, a leading human-rights body, “but it allows the authorities to ignore the real, big issues, anything that's painful to the state.” Those who protest about the war in Chechnya, nuclear waste and labour rights face all manner of harassment and threats. Yet perhaps their worst enemy, she says, is something much more powerful. “Putin is truly very popular. In many respects we're fighting against society itself.” And for Russian society, democracy and human rights are not a high priority right now (see chart 6).



However, Mr Putin's popularity is not quite what it seems. Although polls show his personal approval rating to be a solid 80% or so, far fewer people think his government has done well on most individual issues, even on the economy. Nor are they too confident that it will do better in future. His trick, borrowed from the tsars of old, is to shift the blame on to his underlings: state television frequently shows him sternly ticking off hapless officials for some failure or other. But now that he is seen to be more in control, he may get more of the blame if things go wrong.

If he does, the opposition parties are in no shape to capitalise on it. Mr Putin's succession, and quite possibly his successor's succession, will be decided within the Kremlin. (He insists that he will not change the constitution to seek a third term, and many believe him.) A political opposition will have to be built over many years, from the grassroots. But the grassroots is already becoming an interesting place.

In Ryazan, a three-hour train ride south-east of Moscow, Grigory Shvedov is walking around with a digital camera, taking photographs of every single lamp-post he can find. The lamp-posts display posters about the war in Chechnya, soldiers' memorials, abandoned widows and children, each emblazoned with

an accusatory “How much?” Mr Shvedov records how well each poster has been placed and how it looks from the street.

Don't get despondent, get even

Ryazan is the site of one of Russia's first scientific experiments in civic activism. After a decade of conflict in Chechnya and a series of terrorist attacks in Russian cities, Russians have no sympathy for Chechen rebels, and little for ordinary Chechens: racism runs deep, and the media subtly encourage it. Memorial, a leading human-rights group, has decided to try instead to get people worked up about what the war is costing them: the taxes they pay, the sons and brothers who die serving there, and the lies that their government tells them about it.

This should be an explosive issue. Officially the second of the two wars in Chechnya, starting in 1999, has killed around 5,000 soldiers; according to the Union of Committees of Soldiers' Mothers, a nationwide network of voluntary help groups, the real figure is nearer 12,000. The deaths continue even though officials insist that the “military phase” is over. The size of the military budget and even the military presence in Chechnya are secret. Hazing and brutality in the army are rife, possibly killing hundreds of soldiers each year and causing many more to desert or go insane. Last winter there was an outcry when some young recruits died after officers had made them stand outside without coats for hours.

Young men go to enormous lengths to avoid the draft, paying bribes of $3,000-5,000 if they can find the money, and spending as long as possible in education (the draft ends at 27) if they cannot. That alone produces an extraordinary economic distortion: between 1992 and 2000 the number of colleges in Russia increased by 75%, but many of them, education experts say, are of poor quality, there to satisfy their students' hunger for staying alive as much as their thirst for knowledge. Those who do serve often come back brutalised and alcoholic. Many join the police or other agencies, with the result, says Ms Lokshina, that police brutality is becoming more widespread; there are even signs that torture techniques invented in Chechnya are spreading elsewhere.

So it is no surprise that 87% of Russians have heard of the Soldiers' Mothers, according to a poll by Human Rights Watch. Relatives of missing soldiers, and veterans and widows who cannot get their benefits, invariably turn to their local committee. That makes for a powerful civic force. In 1995 the union collected 1.5m signatures against the first war in Chechnya.

But campaigns have made no headway and apathy has set in. These days anti-war demonstrations in the centre of Moscow pull in only a few hundred people. “We've exhausted everything,” says Valentina Melnikova, the energetic, motherly chairwoman of the union. “The people in power won't react. They were made by TV. They're virtual people.” Earlier this year the union formed a political party, hoping that a handful of Duma deputies might give it more clout. But the omens are not good: a small-businessmen's party formed for the most recent Duma elections polled only 0.3%.

Mr Shvedov, about half the age of his fellow board members at Memorial, is trying a different approach. With help from American advisers, he and the enthusiastic young activists at Memorial's Ryazan chapter designed a campaign. They hired a local sociologist to pinpoint the sensitive issues—in another city, the campaign chosen was about the plight of orphans, to encourage foster-parenting—and road-test the material with focus groups. They found, for instance, that people react badly to posters showing how many schoolbooks one tank shell would buy, because they do not think the army should be kept short of funds, but that they are moved by images of soldiers' suffering. The activists plan to hold public meetings, produce a mini-newspaper, distribute stickers, maybe launch a letter-writing drive. They have exact targets for how many people should see their campaign, how many newspaper articles should appear about it, how many of those should be positive, by how many percentage points public opinion should change.

Compared with the wordy open letters and principled stands of the Soviet-era dissidents who still dominate Russian civil society, it is all very 21st-century, as is Mr Shvedov's language. “The information space has changed a lot,” he says, pointing to the profusion of advertising that his posters have to compete with. “When there are a dozen signs and logos on a street corner you can't hang a 40-page report there. You need commercial methods of delivering information and tracking its effect on the clients.” If the pilot scheme shows those methods to be successful, Memorial will think about choosing an issue for a national campaign.

Modern activism could help to make Russian democracy grow. As Russians become better off, they are

getting keener to challenge the authorities—whether it is over Chechnya, pollution or education standards. But to keep doing this they will need funding. And right now, Russian philanthropists are scared. After Mr Khodorkovsky's arrest, every organisation supported by his Open Russia Foundation was visited by tax inspectors. Some NGOs had been discussing a similar endowment with the Russian Union of Industrialists and Entrepreneurs, the main business lobby group, but “all that is suspended now,” says Ms Lokshina.

Foreign support for activists is discouraged too. America's Agency for International Development, one of the biggest donors, has provisionally agreed to pull out of Russia by 2007. Last year the Peace Corps and the Organisation for Security and Co-operation in Europe's mission to Chechnya left after their operating agreements were cancelled. The Open Society Institute, an international pro-democracy foundation run by George Soros, a famous financier, closed its Moscow office after its landlord demanded a tenfold increase in rent and sent in a gang of thugs. “For everything that we do now, we have to think about how easy it would be to drive us out,” says the Moscow director of one western agency. “The willingness of people in power to take different sides has all but vanished.” Mr Putin has plenty of ideas about how to engage with the West, but taking handouts is not one of them.

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For months, the world's most powerful men had been wooing Mr Putin to use Russia's permanent seat on the UN Security Council either to support or to oppose an attack on Iraq. This presented him with a dilemma: if he supported it, he would look like an American puppet, but if he opposed it, America might bypass the UN, invalidating Russia's biggest remaining claim to being a global power. It never came to a vote; the UN was sidelined anyway; but Mr Putin somehow managed to stay on fairly good terms with everyone all the same.

However, since then a chill has set in. The Yukos affair, the Duma election and the blatantly fraudulent presidential election in Chechnya last October got foreign leaders to take fears about Russian authoritarianism more seriously. The assassination earlier this month of Chechnya's president, Akhmad Kadyrov, made a mockery of Russia's claims that the situation there was “normalising”. The expansion of NATO and the European Union right up to Russia's borders revived old disputes about visa rules, security and trade barriers. The roar of NATO jets patrolling just outside Russian airspace is almost drowned out by the grinding of teeth in the defence and foreign ministries.

Russia has been squeezed into a narrower space. Countries such as the Baltics, which used to be under its thumb, are now members of the EU. Countries such as Ukraine and Belarus, which Russia still considers part of its backyard, are now Europe's neighbours, and therefore its concern. That has brought nasty surprises. When Russia last November brokered a peace deal in Moldova that would have involved Russian “peacekeeping” troops staying there until 2020, it expected no resistance. But Moldova's president, under pressure from European leaders as well as from his own people (who had watched Edward Shevardnadze being swept from power in Georgia only a couple of days earlier), scrapped the deal at the last minute, infuriating the Russian leadership.

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with the EU a decade ago had “an integrationist goal”, says Fyodor Lukyanov, editor of *Russia in Global Affairs*. “It meant that Russia should gradually adopt EU standards. But under Putin, Russia doesn't want to become just like Europe. It won't have human rights as a priority. It doesn't want to be endlessly coming to agreements on things.”

In February the European Commission admitted that its strategy of gradually integrating Russia, the fruit of one of the St Petersburg summits, was getting bogged down. “Russian convergence with universal and European values will to a large extent determine the nature and quality of our partnership,” it observed pointedly.

Bursting with energy

Yet as it looks around its new, smaller *Lebensraum*, Russia sees that the place has something cosily familiar about it: it is a lot like the old Soviet Union. It may now be called the Commonwealth of Independent States (CIS), but their independence goes only so far. The Kremlin sends advisers to help its preferred candidates with election campaigns. It vies with the growing American presence there, using Russia's remaining military bases and, in Georgia, loyal statelets as levers.

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The government is doing much the same. A preliminary agreement on a single economic space for the CIS pushes Russia further from Europe's economic embrace (though it will take ages and may never happen at all). Russia is unlikely to replace the Middle East as the West's main source of oil, but when Russia eventually builds a Far East pipeline, it will forge closer ties with Asia. UES has bought electricity companies in Georgia and Armenia, and Gazprom owns stakes in firms all across the CIS and in much of Europe (see map).

Yet strengthening its hold in the CIS does not mean that Russia is withdrawing from the West. Mr Putin may not care what foreigners think of the way he runs his country, but he cares a great deal about its status in the world, and thinks these two things can be kept separate (after all, they are for China). Now that Russia's Security-Council veto has lost its shine, he will concentrate on his country's prospective chairmanship of the G8 in 2006. He is expected to try hard to get preliminary approval for WTO membership by then.

For that, Russia will have to negotiate with many countries, above all with the EU over the price of the gas it exports there. There are plenty of other shared problems, from drug-trafficking to terrorism to migration, so the West will continue to have plenty of dealings with Russia, as well as considerable leverage.

One way of using this wisely will be to show Mr Putin that his approach to many of his domestic problems makes them the world's problems too. He believes that Russia needs a strong leader to contain threats such as economic and political refugees, a decaying army, terrorist breeding-grounds and epidemics spiralling out of control. But the strength that enables the country to cope with all this is also a weakness: at the moment too much depends on the man at the top. A sudden jolt (a sharp economic downturn, a new outburst of terrorist attacks, or any mishap that might befall Mr Putin himself) could tip the country over the edge again. A more democratic Russia would be a more stable one, and less worrying for the world in general.

The riddle of the sphinx

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But now that Mr Putin is as much in control as he ever will be, the next few months should provide a clearer indication of where he is heading. Telltale signs will be whether he lets his reformist ministers get involved in issues that have so far been the province of the *siloviki*, such as military spending; how he brings the Yukos affair to a close; whether he encourages the oligarchs to invest in ways that help develop the economy rather than merely plug holes in state welfare spending; and how he responds to his officials' more retrograde ideas (he recently softened a law restricting public gatherings after an outcry against it).

In broad terms, though, Mr Putin's agenda for Russia is clear: he wants it to be a global power and an economic tiger, but also a controllable, monolithic state where suggestions are welcome but opposition is not. “Russia was not a democracy in the 1990s and it's not an autocracy now,” says Nina Khrushcheva, a professor at the New School in New York. “Russia is a process, but we always insist on labelling it as a finished product, as this or that, and then scold it immediately if it doesn't fit.”

Yet the 20th century had many such countries in transition, and many of them stayed that way for decades before the system cracked and democracy started to seep in: think of Mexico, South Korea, Malaysia, Chile, Singapore. Russia is not what it was 13 years ago; it is not what, 13 years ago, everyone hoped it would be today; nor is it better or worse; it is simply what it is. And given how fast things change there, tomorrow it might well be something completely different.

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Industrial policy

Creating Euro giants

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What is the French and German plan to create bi-national champions really about?

THE latest attempt by France and Germany to revive tired old industrial policies by jointly creating European business champions got off to an inauspicious start. Before the German chancellor, French prime minister and their respective economy and finance ministers could hold their summit in Berlin on June 1st to hammer out the details of the plan, on May 17th Nicolas Sarkozy, the French finance minister, and Mario Monti, the European Union's competition commissioner, agreed a rescue deal for Alstom, a troubled French engineering firm, that flies in the face of the new spirit of co-operation.

Siemens, a huge and prosperous German firm, has expressed a strong interest in buying Alstom's turbine business—on the face of it, a perfect opportunity to create a symbol for the new policy. Instead, under the deal between Messrs Sarkozy and Monti, Alstom will remain a French company, bailed out by the French state. This decision led several German officials to complain about France going it alone. Siemens is considering a legal challenge, once the details of the rescue package are official.

In theory, at least, the French and Germans have in mind a different sort of national champion to the inefficient, protected monopoly, state-subsidised sort of which Alstom is a reminder. A classic example of the old-style champion, says Louis Schweitzer, chairman of Renault, is Fiat before the EU forced open the Italian car market. The new sort of national champion, or Euro champion, would have a somewhat different objective, says Mr Schweitzer: to ensure that Europe, or a given European country, has firms able to hold their own in competitive global markets, particularly against America's mighty multinationals. This, he says, is the logic behind the recent controversial drug merger, pushed by the French government, of Sanofi-Synthélabo, a French company, with Aventis, a Franco-German firm.

We are the champions

France and Germany launched their new plan on May 13th, when they declared an intention “to formulate a joint industrial policy aimed at creating a framework for mergers and joint-ventures between major German and French corporations”. Together Germany and France could create a number of industrial champions modelled on EADS, the European Aeronautic Defence and Space firm, formed in 2000, said Jacques Chirac, the French president.

Such a policy would have its downside even if it was being pursued in conjunction with general economic liberalisation. But there are reasons to think that the big talk about cross-border action may be mere cover for various politically driven national initiatives in France and Germany, many of them protectionist.

Germany recently tried to discourage a mooted foreign takeover of Deutsche Bank by pressing Germany's biggest bank to bid for Postbank, a division of Deutsche Post, the national mail service. (America's Citigroup has reportedly been in talks with Deutsche Bank.) France's intervention record has been offensive to economic liberals since long before the recent sagas. Liberalisation exists to create champions, not to destroy jobs, said Mr Sarkozy at a recent press conference. “Sarkozy has been very nationalistic and protectionist in his policy decisions since he became finance minister,” says Richard Portes of the London Business School.

Frits Bolkestein, the fiercely liberal European commissioner for the internal market, is furious about the “pathetic” Franco-German plot to nurture industrial champions. According to Mr Bolkestein, the “Lisbon strategy” agreed by EU leaders in March 2000 was all about the creation of conditions in which business, not bureaucrats and politicians, could transform Europe into the most competitive economy in the world by 2010. “I cannot help feeling a sense of *déjà vu*”, says Mr Bolkestein. In the 1960s France pursued a highly interventionist industrial strategy under the governments of Georges Pompidou. *Le Monde*, a French daily, recently called current policy *“un pompidolisme chiraquisé*” (Pompidou's policies the Chirac way).

There are good reasons to think that when Mr Sarkozy talks of European champions he really means French champions strengthened by a link with Germany—when that suits France's interests. And, despite their anger over Aventis and Alstom, the Germans are going along with the joint industrial policy out of political expediency. They fear that if they do not do the same as the French, they will be at even more of a disadvantage, says Frédérique Sachwald, an economist at IFRI, an institute for international relations in Paris.

Can national champions work? Sometimes, but only in exceptional circumstances. Air France and Renault, two national champions that are now prospering having almost gone bust, are examples of successful state bail-outs, says Ms Sachwald. But in general, any artificial promotion of national champions tends to hinder the development of a successful corporate sector, says Colin Mayer of the Said Business School in Oxford. Far better to create the right environment, as per the Lisbon strategy, through deregulation, competition and so on.

The first big cross-border Franco-German merger since the new policy was launched may not be far off. On May 17th ThyssenKrupp, a German steel conglomerate, announced a merger of its shipyards with Howaldtswerke-Deutsche Werft, a German submarine-maker. The Thyssen-Krupp/HDW deal is likely to result in a merger with France's Thales, a defence company with naval interests, and DCN, a French state-owned shipyard. Klaus Rettig, the boss of Thales in Germany, reportedly thinks that Europe needs a “naval EADS”. After the ThyssenKrupp/HDW deal, Ekkehard Schulz, head of ThyssenKrupp, said that a European solution will be the next step. Thales has long been interested in HDW and is already working with DCN on a new aircraft-carrier. A naval EADS would make business sense as it would take some capacity out of the market, say some analysts. A Franco-German naval group might also be better placed to compete with America's naval giants, Northrop Grumman and General Dynamics.

But the French government is not always driven by the business case in its industrial-policy choices. If it were, it would surely have let Aventis merge with Novartis in spite of the latter's Swissness. Likewise, it should let Siemens buy Alstom's turbine business. “The French do not let the market for corporate control function,” says Philippe Haspeslagh, a professor at INSEAD, a business school.

The new industrial policy may anyway fall foul of Brussels. Both Mr Bolkestein and Mr Monti have become increasingly assertive against state aid and monopoly—and they or their successors seem unlikely to reverse that course. If France and Germany persist in blocking investments in their champions from further afield, the European Commission can pursue them under EU rules on free movement of capital, as it is doing with a German law that protects Volkswagen, says Mr Bolkestein. If they pump subsidies into their champions or give them tax breaks, the EU can block them. Mr Sarkozy went to Brussels three times in the past two weeks to discuss Alstom. Maybe he should buy a season ticket on the Thalys, the high-speed train built by Alstom to link Paris and Brussels.

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About sponsorship

Convenience food

Changing the menu

May 20th 2004
From The Economist print edition

Why food companies are joining the crusade for healthy eating

WHEN Morgan Spurlock decided to make it big in the movies he did so by stuffing himself with nothing but food from McDonald's for 30 days. Having put on 25 pounds (12kg) he “felt terrible.” His documentary, “Super Size Me: A Film of Epic Portions”, was released in America in mid-May with food firms bracing themselves for more than just another helping of bad publicity. Many are having to overhaul their product lines because of the growing concern of consumers and governments about obesity.

A salad with your fries, sir?

McDonald's says Mr Spurlock acted “irresponsibly by consuming more than 5,000 calories a day—twice the recommended level for adult males—and by purposely limiting his physical activity.” Still, his film makes the point that the convenience of modern food means that it is easy for people to eat unhealthily.

McDonald's is now offering more healthy choices. Earlier this year, it decided to phase out its “supersize” portions of fries and soft drinks. In America this month it launched an “Adult Happy Meal” that includes a salad, bottled water, a pedometer and a booklet of walking tips. Charlie Bell, McDonald's new boss, says this has helped to boost takings. Comparable sales for its 30,000 restaurants in April were 10.5% higher than a year earlier.

Many of America's other big food firms are changing what they make and how they label their products. Some of this is in response to consumer trends, in particular the rise of low-carbohydrate eating, thanks to the Atkins and South Beach diets. New research shows these diets can help people lose weight faster than traditional low-calorie diets (see article).

Kraft Foods this month launched a range of lower-carb foods, including fudge brownies and snack bars. Next month it will launch low-carb versions of its breakfast cereals, Cinnamon and Golden Crunch. Low-carb barbecue sauces and salad dressings are also coming. Frito-Lay, the convenience-foods arm of PepsiCo, is launching low-carb versions of its doritos and tostitos (sales of the full-carb versions are nearly $3 billion a year).

This does not bode well for producers of high-carb products involving bread, cereal and pasta. Krispy Kreme, a big doughnut maker, has blamed in part rising interest in low-carb diets for its recent profits warning. On May 10th, New World Pasta, one of America's leading pasta producers, filed for bankruptcy

protection in part because of falling pasta sales.

Some moves by food companies anticipate new laws that would give consumers more information about what they eat. Ruby Tuesday, which has more than 700 restaurants in America, last month began to include on its menu details of the calories, fat, carbohydrates and fibre in its dishes. McDonald's, which already provides nutritional information about its products, has been experimenting with printing the details on its paper tray-liners.

Admittedly, the extent to which consumers are opting for healthier food can be exaggerated. A report in Britain this week appeared to indicate that sales of snack foods are falling: so-called “impulse” purchases of salty snacks, such as crisps, have slumped by almost 11% in the past year, and sales of chocolate bars are lower. But as food campaigners quickly pointed out, this is more than accounted for by a switch to buying more multi-packs at supermarkets. Conveniently for the food industry, the figures came out just as a bill was presented to Parliament seeking to limit the promotion of some foods to children.

Meanwhile, expect to hear from others trying the 30-day McDonald's plan—but choosing their meals more carefully and exercising regularly in the hope of making a name for themselves by losing weight. Mr Spurlock has since shed 20 pounds, but is finding the last five pounds hard going. Perhaps he should try Atkins.

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Oracle v Peoplesoft

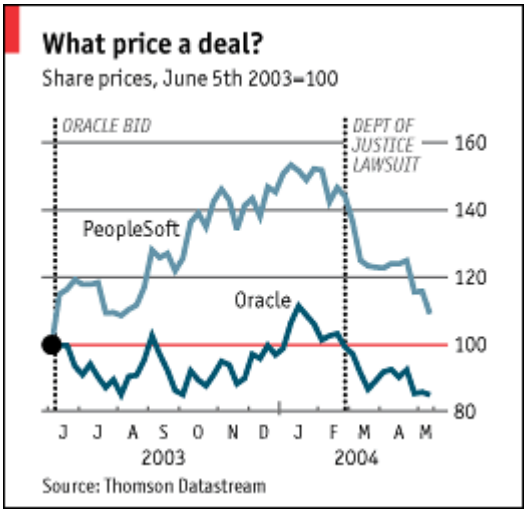
Larry's art of war

May 20th 2004 | NEW YORK
From The Economist print edition

How close is Oracle to victory?

HAVING rejected Oracle's offer to buy Peoplesoft at $16, $19.50 and then $26 a share, what will Peoplesoft's board of directors make of its arch rival's latest entreaties? Citing market changes, on May 14th Oracle announced that it was now offering Peoplesoft's shareholders $21 a share for the world's third-largest business-software firm. With Peoplesoft's shares having slumped to below $17, that $26 offer spurned by Peoplesoft's board in February does not look so bad.

Oracle first launched its hostile bid for Peoplesoft in June 2003. Since then, Peoplesoft has justified rejecting all of Oracle's advances—and its deployment of various anti-takeover devices—by making two points to its shareholders. First, says Peoplesoft's board of directors, all of Oracle's offers so far have undervalued the firm. Second, the merger may be thwarted anyway by the Department of Justice's (DOJ) antitrust arm, which filed suit to block the bid in February.



Oracle's boss, Larry Ellison, has decided to fight the DOJ's suit, and both sides are preparing for court hearings next month. So far, Oracle has been making all of the running. Editorials in the business press (*The Economist* included) have lambasted the government's arguments, which rest on a rather narrow definition of the software market in which Oracle and Peoplesoft operate. The DOJ defines this as companies that sell complete suites of software to big firms. This market, says the DOJ, contains just three competitors: SAP, Oracle and Peoplesoft.

Leaders at rival software firms have professed puzzlement at the government's theories about the software industry. Microsoft, the industry giant, has continued to make aggressive investments in its business-software efforts. That is surely competition, as is the booming software industry in Bangalore. Many specialised niche software firms continue to enjoy success. Perhaps most embarrassingly, even the DOJ appears to be in two minds about how the software market works. In April, it emerged that the department's own IT people had picked American Management Systems, a small, specialised software firm, to supply the DOJ with $24m-worth of financial software. The rival bidders for the admittedly small contract were Oracle and Peoplesoft. Oracle's spin doctors gleefully argued that the government had just disproved its own theories.

Presiding over the trial of the DOJ suit is Vaughn Walker, a judge who is unusually expert in antitrust law, and who has previously tangled with the DOJ's antitrust arm over a newspaper sale in 2000. Many of the DOJ's published witnesses are Peoplesoft customers, who from the beginning have felt threatened by Oracle's bid. Oracle has gathered what looks to be a broader mix, including rival software firms, customers and economists. Both Mr Ellison and Craig Conway, Peoplesoft's boss, have been called to testify.

Perhaps Justice Walker will discover reason and evidence in the government's case. Then Oracle would need to find new sources of growth in a maturing market. But Peoplesoft would then face the challenge of repairing a business that has weakened significantly during the lengthy bidding war. And if the DOJ should lose? Peoplesoft would be left with a damaged boss (and board), a falling share price and, perhaps, a full-scale shareholder revolt. Whether or not Mr Ellison would then choose to continue to pursue his bid (perhaps with an even lower offer), Oracle would probably emerge the winner. As the title

of a recent book about Larry's art of war puts it, everyone else must fail.

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Consumer electronics

Plasma power

May 20th 2004 | TOKYO
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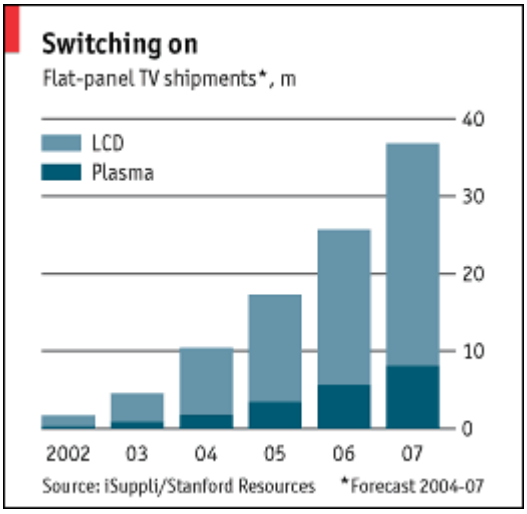
Japanese firms raise the stakes in the flat-screen television war

THOSE pesky South Korean and Taiwanese firms keep nipping at their heels, but Japan's consumer-electronics giants are still finding ways to stay ahead. Matsushita served notice this week that, for some time yet, Japan will continue cranking out that quintessential home-electronics product—the television. On May 18th, the maker of the Panasonic brand announced that it will build the world's biggest plant for plasma-display panels, which are used in the largest flat-panel televisions.

The rapid emergence of flat panels as the new standard, supplanting those TVs made with bulky cathode-ray tubes, initially made Japanese firms look bad. Samsung Electronics and LG Philips LCD—the first South Korean, the second a joint-venture between Korean and Dutch firms—make more than 40% of the panels used in liquid-crystal-display (LCD) televisions, according to DisplaySearch, a consultancy. Although Japan's Sharp pipped LG Philips last year as the world's leading maker of LCD panels, its supposedly “cutting-edge” factory in Mie prefecture is a generation behind Samsung Electronics's newest LCD plant, and is already being replicated by various Taiwanese competitors.



Japanese firms, however, have been doing better with the other kind of flat-panel technology. Plasma panels are based on a different technology from LCDs, one that is much more efficient for screens bigger than 37 inches (94cm) or so. As global demand for giant high-definition TVs grows, Japanese firms should be in better shape. According to DisplaySearch, four Japanese firms (Matsushita, NEC, Pioneer, and a joint venture between Fujitsu and Hitachi), had a combined global market share in flat panels of over 60% last year.

Those firms hope that the spread of high-definition broadcasting in America, Europe and Japan will spur demand for plasma panels. Hence Matsushita's ¥95 billion ($840m) factory, which will be able to make 37-inch, 42-inch and 50-inch panels. Besides newer technology, the plant will boast nearly triple the capacity of Matsushita's three existing factories (two in Japan, the other in Shanghai)—enough to crank out 250,000 of the 42-inch panels a month.

Japan's plasma-panel makers are already worried about competition, however, and are jealously protecting their technological edge. Fujitsu, which owns a slew of important plasma-related patents, has sued Samsung SDI, claiming that the Samsung Electronics affiliate has violated several of these patents. Last month, because of the dispute, Japanese customs officials blocked imports of Samsung SDI's plasma displays. As the latest battle in the flat-panel television wars comes into high definition, it should be fun to watch.

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Patents

Still pending

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The EU's attempt to harmonise patent law is in a mess

TO QUALIFY for a patent, an invention must advance the state of the art. Alas, the same test does not apply when approving reforms to Europe's patent policies themselves. This week the European Union's Council of Ministers failed to agree on one important proposal, and accepted another that may actually undermine rather than foster innovation.

The first proposal was for a “Community Patent”. Its aim was to simplify the application process by making any patent awarded by the European Patent Office valid across all 25 EU nations, without having to be fully translated into all of the EU's 20 official languages. (The cost of translation makes getting a patent in Europe far more expensive than in, say, America.) This would have created broad patent-protection and cut costs for inventors. But some countries objected to this loosening of the rules, splitting the council—so after four years of negotiations and three decades of debate, the proposal is dead.

A second initiative was a directive to harmonise national rules on software patents. The matter is controversial because the intellectual property of software is typically protected through copyright. This prohibits plagiarising code, but allows competitors to devise different code that achieves the same end. Patent law, in contrast, outlaws any other software that achieves the same effect, no matter how. Dubious software patents abound: the best-known example is the American patent awarded in 1999 to Amazon for the “one-click” shopping model used at its online store.

Although software patents are already allowed in most European countries, they are awarded and enforced unevenly. The Council of Ministers approved the draft directive, but, crucially, in a form that lacked amendments made by the European Parliament last September that restricted its scope. The two versions thus differ greatly, reflecting two sides of a polarised debate. The council favours software patents, a boon to big technology firms and intellectual-property holders. The parliament opposes software patents, and generally favours smaller firms and open-source software developers. From here, the directive will grind through the EU bureaucracy, getting tweaked along the way. It will be at least a year before it comes to a final vote, assuming it gets that far.

Clearly there may be cases where a better digital mousetrap is worthy of a patent. But if software patents are too easy to obtain, they may stifle innovation more than promote it. Europe needs tougher standards governing their approval (and perhaps shorter terms of protection). As for creating a Europe-wide patent, like a common currency it would be of great benefit to industry—so, recent difficulties notwithstanding, the effort should be renewed.

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Outsourcing in India

Growing up

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A young industry consolidates

THERE comes a point in any boom when the weak go under and the strong go shopping. In India's thriving software and remote-services industries (call centres, for instance) bigger fish have for some time been gobbling up small-fry. The shake-out has barely begun, but already has a cross-border dimension. The result may be an entirely new sort of global services-company, with its roots in India.

The boom is unlikely to be stalled by India's startling change of government (see article). This is a golden goose that even the new regime's Communist component wants to cherish. Yet at one end of the business, many of the hundreds of call-centre operations that have opened in India in the past two years are struggling. Revolving-door rates of staff attrition, rising wage costs, a stronger rupee and unhappy customers may drive many out of business.

Among top-end firms, however, the expansion continues. India's revenue from “business-process outsourcing” (BPO) grew by some 50% last year to $3.6 billion, a feat it should repeat in 2004 according to Ernst & Young, an accounting firm. Despite protectionist ballyhoo in America, the main impetus for this expansion remains the buoyancy of the market there.

Just this month, Tata Consultancy Services (TCS), India's largest IT firm, announced its purchase of the Bangalore-based subsidiary of Phoenix, an American insurer and asset-manager. The Indian unit, employing about 400 people, provides software-development and other services to its parent and other insurers, and will strengthen TCS in an industry already providing nearly 15% of its revenues, according to Atul Takle, a TCS spokesman.

This illustrates one of four trends converging in an industry-wide consolidation. Some multinational firms with “captive” offshore operations in India, such as Phoenix, are thinking of selling them—in effect, outsourcing through divestment. Even GE Capital's Indian arm, the biggest of all the captives, is reported to be considering selling some of its operations.

Second, young, fast-growing India-based firms, flush with cash and besieged by would-be investors offering more, are thinking of acquisitions as a way to sustain growth. Sanjay Kumar, for example, boss of vCustomer, a firm with its headquarters in Kirkland, Washington, says the number of people it employs at call-centres in India is likely to double this year to 7,000.

He hopes to buy an American BPO firm with annual revenues of about $50m. The aim is to broaden the range of services he can offer, and to reach clients who are not yet comfortable with buying remote services offshore. Compared with the high valuations that Indian BPO firms now attract, his American targets look cheap, and finance is “not a challenge”.

Similarly, OfficeTiger, a remote office-services firm with its main base in Chennai, is planning to expand by buying an outfit in Britain. Joseph Sigelman, its co-chief executive, says it has agreed $25m in acquisition finance as part of an investment from a private-equity firm.

Thirdly, while these upstarts race to expand in their target markets, the big western IT consultancies are reversing the process. Last month, mighty IBM bought Daksh, one of India's biggest call-centre firms, with about 6,000 employees. The deal, worth about $170m, is much the biggest in the Indian market so far. It sparked a flurry of rumours that similar deals are in the offing from IBM's rival global IT consultants, such as EDS and Accenture.

Finally, as these multinationals bulk up in India, extending the range of their wares to include call-centre

and other BPO operations, Indian firms such as TCS have been matching them—as well as expanding overseas. Of the other two Indian software firms with annual revenues of over $1 billion, one, Wipro, bought Spectramind, India's largest third-party call-centre firm, in 2002 and last year acquired NerveWire, a Massachusetts-based IT consultancy. The other, Infosys, also established its BPO subsidiary, Progeon, in 2002, and last year bought Expert, an Australian IT firm.

Most intriguing of all, Infosys has set up its own consulting arm in America. It is luring high-powered consultants from big American firms such as EDS and Deloitte, and plans to hire 500 people within three years. As multinationals compete for low-cost outsourcing work in India, Infosys is taking the fight to their core markets.

Using a topical term from Indian politics, Infosys's chief executive, Nandan Nilekani, detects an “anti-incumbency wave” among firms that have spent heavily on consultants yet not improved their bottom lines. He aims to move Infosys into unoccupied territory—where cheap global delivery of high-quality IT-services meets elite business consultancy.

His multinational rivals are converging on the same goal from the opposite direction. Mr Nilekani argues that firms such as his, based in India but with global reach, have an inbuilt advantage over the foreign giants with huge cost structures. For a young firm still small by international standards, that sounds presumptuous. But given the success of some Indian IT firms in the past decade, who would bet against them meeting their targets in the next?

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Business in the Americas

Miami nice

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The emergence of a business capital

LONG accustomed to being just a hub for Latin America and the Caribbean, Miami recently awarded itself an upgrade. It now advertises itself as the “Gateway of the Americas”. But why should an ambitious Florida city stop there, when “Capital of the Americas” beckons? Or even “Centre of the New World”, as one of its glossy brochures has it? For that is what Miami is now pitching for: already it has launched a big campaign to host the headquarters of the proposed Free Trade Area of the Americas (FTAA).

Only 20 years ago, Miami had a serious brand problem, mainly thanks to the corruption and drugs that provided such good storylines for the TV series “Miami Vice”. No longer. The FTAA office would further entrench the city's burgeoning reputation as the business and finance capital of the Latin market, both in the United States and in Latin America itself.

But it faces competition to host the FTAA. Other cities in the region are determined to outdo Miami as the link between the north and south of the Latin markets. Latinos are now the largest minority in America. Many firms view the American-Hispanic market as their most dynamic growth opportunity.

But Miami has a head-start. For one thing, says Tony Villamil, head of the Miami-based Washington Economics Group, “we are basically a Latin American city in the United States.” There is probably no more ethnically diverse city in Latin America either. Of Miami-Dade county's 2.3m population, over half were born outside America. Most are Hispanic, with around 700,000 Cubans, 100,000 Haitians and 40,000 Jamaicans. Bilingualism is passé. At the airport, announcements are made in English, Spanish and Creole.

Many of these immigrants came to Miami as political refugees. In the process, they have made Miami the place where gringos can come to check out the Latin and Caribbean environment. Miami's role as the point of interaction was officially recognised by the Clinton administration, which picked the city to host the first Summit of the Americas, in 1994.

Incoming Latin American businesses quickly feel at home. In recent years, many have made Miami their hub for the Americas. LanChile, a Chilean airline, has its regional headquarters here, for example. Embraer, a Brazilian aircraft-maker, has its headquarters for North America near the city. Televisa, a big Mexican TV group, recently announced expansion plans here.

Unlike most of their home countries, Miami offers Latin America's businesses political and financial stability, a comparatively transparent and efficient legal system, and superb communications, combined with the lifestyle of South Beach.

In turn, American firms have made the city their headquarters for the American-Hispanic market. It is home to the second biggest American Hispanic broadcaster, Telemundo, and for MTV Networks Latin America. Miami also has one of the biggest concentrations of multinational banks in the hemisphere outside New York—mostly there for the Latin connections.

Miami thus seems happily trapped in a virtuous circle, as Latin investment begets more Latin investment. Jorge Arrizurieta, head of Florida's bid for the FTAA headquarters, argues that he sees his job as no more than “asking old friends to ratify the situation that already exists”.

Can anyone stop it? Atlanta, Georgia, is mounting a serious bid for the FTAA, as is the Mexican city of Puebla and Panama City in Panama. But perhaps the strongest rival will be Puerto Rico, which is aiming to give Miami a run for its money—both for the FTAA headquarters and as pan-regional centre. Héctor

Mayol, president of the Chamber of Commerce there, argues that Puerto Rico's capital, San Juan, “offers a natural bridge between the United States and Latin America”.

Anti-American sentiment throughout Latin America could yet put Miami at a disadvantage, and Puerto Rico sees itself as a good cultural and political compromise. Mr Mayol argues that international business is now investing heavily in the country. It already has the region's biggest pharmaceuticals business, with exports worth about $35 billion a year. Spanish banks constitute about 40% of its banking sector. Let battle be joined.

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Face value

Putting Italy back on the podium

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Iberpress

Having led Ferrari back to greatness, can Luca di Montezemolo do the same for the whole of Italian industry?

WHEN Michael Schumacher climbed on to the winner's podium after the Spanish Grand Prix on May 9th, he had completed his fifth victory in five races so far this year. Ferrari, his motor-racing team, is dominant, as it has been in every grand-prix season since it recaptured the constructors' championship in 1999, after an ignominious gap of 16 years. The sight of Ferrari's flame-red car taking the chequered flag in race after race frustrates its rivals, and bores many fans of the sport, but it never fails to satisfy the firm's boss, Luca Cordero di Montezemolo. “Just winning is hard enough. To keep on winning is far harder,” says the man who found out all about the difficulty of winning in the first few years after he took charge of the Fiat subsidiary in 1991. Ferrari failed to win a grand prix in 1991, 1992 and 1993, and won just one in each of the following two years.

Now Mr Montezemolo is taking on an arguably even tougher challenge. Having led Ferrari out of the wilderness, he now hopes to do the same for Italian business—which is currently struggling to cope with the strong euro and competition from the developing world. On May 27th, he will become the new chairman of Confindustria, the Italian employers' confederation—and thus the official face of Italian business. Long at the centre of Italian industrial and economic policymaking, Confindustria has lately lost much of its clout and, like corporate Italy itself, badly needs some of Mr Montezemolo's magic.

His arrival at Confindustria marks the return of Italian industry's northern aristocracy which, having run it in its prime, lost interest in the organisation in the 1990s. This may indicate how severe corporate Italy's problems have become—not least those of near-bankrupt Alitalia and not-much-better Fiat.

Mr Montezemolo has spent most of his working life in the Fiat group, where he was a favourite of the late Gianni Agnelli, a long-time boss of Fiat often described as Italy's uncrowned king. Agnelli himself was Confindustria's chairman 30 years ago, before being succeeded by another member of the Fiat court, Guido Carli. Luigi Lucchini, a Brescian steel baron, headed Confindustria from 1984-88, followed by Sergio Pininfarina, head of an automobile-styling concern that works for Fiat and Ferrari.

Mr Montezemolo is likely to champion improved ethics in Italian business, not least to repair the damage caused by the massive scandal at Parmalat. He is also likely to urge companies, especially the family firms that are the bedrock of the Italian economy, to improve their governance through greater

transparency, more plausible accounting and a clearer separation of owners and managers. As well as raising the efficiency of many of these firms, getting its own house in order will give Italian industry more credibility when it demands that the government do likewise. Italy's tax system is burdensome. Its red tape remains notorious, even by continental European standards. And its infrastructure, above all its roads, increasingly constrains the economy, not least in the most productive northern parts.

To this end, expect Mr Montezemolo to end the partisanship of recent years. Under its outgoing chairman, Antonio D'Amato, Confindustria nailed its colours firmly to the mast of Italy's right-wing government. That may have made sense at first, when Silvio Berlusconi seemed committed to pro-business reform. But, as it became ever clearer that Mr Berlusconi's government was delivering nothing worthwhile to business (his own television firm proving a notable exception), party loyalty stopped Confindustria pointing this out in public. At the same time, its shrill criticism of the trade unions made them even less supportive of pro-business reforms than they might otherwise have been.

Vittorio Merloni, head of the large white goods group that bears his name and chairman of Confindustria during 1980-84, argues that Confindustria should treat all parties equally—just as it did in his time. Mr Montezemolo is likely to heed that advice, and also to adopt a less confrontational approach to the trade unions. The hope is that greater distance from the governing party will not mean less influence—indeed, it is hard to imagine less influence than Confindustria has had lately. Mr Montezemolo has already been willing to criticise those in power. As chairman of the newspaper proprietors' association, a role he had via Fiat's ownership of *La Stampa*, a leading daily, he castigated Mr Berlusconi over his recent self-serving media legislation.

Off to a quick start

“There are no one-man shows,” observes Mr Montezemolo. Teamwork, he says, is above all what drove the revival of Ferrari. (Passion, commitment, a “maniacal attention to detail”, and an emphasis on continuous improvement of every aspect of the business also helped, as did spectacular amounts of Fiat's money.) He has already put together an impressive 14-strong team to support Confindustria, including leading Italian businessmen such as Pasquale Pistorio of ST Microelectronics and Marco Tronchetti Provera of Telecom Italia. The motivational skills that Mr Montezemolo displayed at Ferrari will no doubt come in handy when prodding sluggish industrialists and reluctant politicians into action.

Even so, he should expect a gruelling four-year term. Italian industrialists mostly view the Confindustria chairmanship as a mug's job, involving more sacrifice than satisfaction. Luigi Abete, now boss of Banca Nazionale del Lavoro, says Confindustria took 14 hours a day when he chaired it a decade ago. When Mr Merloni was chairman, the job absorbed him completely from Tuesday to Saturday. And it cost him more than mere time. “Merloni Elettrodomestici was a thriving medium-sized company when I took on Confindustria's chairmanship. Four years later it was a smaller business and losing money,” he says. No doubt rival grand prix teams are praying that Mr Montezemolo's efforts at Confindustria will have a similar impact on Ferrari.

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Business schools

But can you teach it?

May 20th 2004
From The Economist print edition

Alamy

No form of education is more commercialised than management education. But are business schools teaching the right things?

Get article background

APPLICATIONS to business schools are down this year—at least in America, where management education was born and where business schools still award about 85% of the world's business degrees. Kenneth Dunn, dean of Carnegie Mellon's Tepper School of Business, says that applications for the full-time MBA programme, one of the country's best, are about 30% lower than this time last year. Allan Conway of the University of Calgary, and programme director of the MBA Roundtable, an industry body, estimates that applications this year for MBA programmes in America are down by between 15% and 25% on 2003.

Does that spell disaster? Not for top schools such as Tepper, which turn away far more applicants than they accept. Applications for MBA courses are counter-cyclical: they tend to rise when executive jobs are scarce and shrink when they are plentiful. This year's decline is a sign of the current economic boom, just as the 40% rise in applications to Tepper two years ago partly reflected hard times in the managerial job market.

But business schools face more competition, and more criticism of the quality of their work, than they have ever done before. In time, that may lead to fundamental changes in the structure of the business-school market, and perhaps in what schools teach and how they teach it.

The demand for business education has certainly grown at a phenomenal rate. As Paul Friga of Indiana University, co-author of a paper* on the future of business schools, points out, business degrees rose from 14% of all undergraduate degrees in 1971 to 21% in 2001, and MBAs from 11% to 25% of all master's degrees. American universities award more than 100,000 MBAs a year. And business education is booming in places where it hardly existed a quarter of a century ago. In Britain, for example, enrolment on MBA courses grew by 35% in five years in the late 1990s and business schools have become one of the country's top 50 exporters. China now has at least 21 MBA programmes run with American partners, and another 40 or so run by Chinese universities alone. In Russia and central and eastern Europe, more than 1,000 new business schools sprang up during the 1990s.

Why the boom? After all, in America at least, there are fewer jobs for middle managers. The answer may be that people yearn for the riches that they think a business career will bring. A hungry young doctor or

lawyer may see an MBA as a short-cut up the corporate ladder. Business schools sell themselves as a way for students to raise their incomes. Jeffrey Pfeffer, from the Graduate School of Business at Stanford University, argues in a critical article† that the basic business proposition of business schools, especially those with MBA programmes, is “the enhancement of the careers, measured mostly in terms of salary, of their graduates”.

Diversify and grow

Vigorous though the market for business education may be, it is no longer the traditional full-time MBA that is driving the growth. In all but the smallest programmes, says Mr Conway, that source first lost momentum in the early 1990s and then stalled by the late 1990s. In response, schools found all sorts of ways to supplement the core business of the conventional MBA. However, some of these activities are now under threat, for various reasons.

Thus 15 years ago, schools launched executive MBAs, charging premium prices and suggesting to companies that such programmes might be a handy tool to retain itchy-footed high-fliers. Whereas individual students usually carry the cost of an ordinary MBA, companies often finance an EMBA. However, employers have since grown wary of sending good managers on a course from which they may be poached by a rival or where they may suddenly decide to make a career change and leave to start their own business. The MBA Roundtable's figures suggest that applications for executive MBAs are 15-20% lower this academic year than they were in 2003.

More successful are evening and part-time MBAs, often backed with distance learning to allow students to pursue the course off-campus. There are now significantly more evening MBA programmes than full-time ones, says Mr Conway. More than 48 American business schools now offer online MBAs, among them upstarts such as the universities of Phoenix and Webster, both with annual enrolments of around 4,000 and 7,000 full- and part-time MBA students respectively.

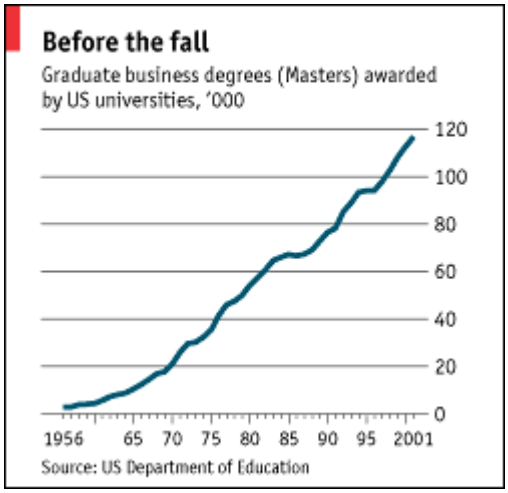
The other big money-spinner has been foreign students, who account for 20-30% of students on many American MBA programmes. At the top European schools, the proportion of foreign students is much higher: at IESE in Barcelona, for instance, Spanish students account for only around 20% of each year's class, a proportion that is carefully managed to retain the international flavour of the school. But here, too, American business schools face a threat from the squeeze on visas to study in America. For example, 25% of the students in Tepper's current first-year class come from abroad, well down on two years ago when the share was 36%.

Profitable or pleasurable?

The biggest of all the revenue boosts has been executive education: short courses that do not lead to accreditation, but offer mid-career training to company managers. They are handily pro-cyclical—companies spend on them in boom years—so that they offset the counter-cyclical swings in demand for MBAs. They have expanded hugely, and now often account for over half of a business school's revenues. Some top schools, such as MIT and Stanford, do little executive education; others, such as Columbia in New York, INSEAD in France and IMD in Switzerland, do lots. Harvard Business School offers no part-time or executive variations on the conventional MBA programme. But it does offer executive education, despite grandly turning down most of the companies that want its academics to work with their staff and refusing the usual quibbling over fees.

Off-the-peg (or open-enrolment) courses are harder to sell these days. They face competition from, among other things, companies' own “universities”, of which there are now some 1,600 in America, more than the 1,300 or so conventional universities offering undergraduate business degrees. “There has been a huge swing to custom programmes,” says Fiona van Haeringen of IESE, who attended a recent annual conference of business-education providers in America. “The market is very aggressive, very competitive and the power is with the buyer.” Don Kuhn, executive director of Unicon, a group of about 75 business schools around the world that offer executive education, says that a survey of about 40 members found that three-quarters of them said overall revenues had grown between 2002 and 2003, but the remaining

quarter said they had declined. Looking to this year, most saw growth coming mainly from customised education tailored for one company. “It's just knocking the cover off the ball,” rejoices Richard Vietor, who was until recently in charge of executive education for Harvard Business School.



The trouble with executive education is that it draws faculty away from teaching MBAs and doing research. It also brings business schools into territory that is under attack from a host of commercial competitors, such as consultancies, private-education firms and executive coaches. That in turn raises questions about paying faculty. John Quelch, who once ran the London Business School and now teaches at Harvard, points out that Harvard can resolve such conflicts by picking only the clients who raise questions that challenge and intrigue its faculty. Faculty are paid extra for work on customised programmes, but not for teaching open-enrolment courses. Lesser business schools find the dilemmas greater.

And the competition is growing. Mr Kuhn bewails the fact that companies increasingly buy their executive education through purchasing organisations, which treat it like any old commodity and demand complicated contracts with lots of targets and conditions. IESE's Miss van Haeringen frets that companies increasingly want evidence of a return on their investment. “That is really tricky,” she confesses. “We can't fully control what people learn and what they come out with.”

But it is not just executive education that is becoming increasingly competitive. In future, the market for MBAs may well polarise. At one end will be the elite schools, fighting furiously for their place in the various rankings tables. American schools dominate the 2004 *Financial Times* ranking, the most European of the annual lists; only five of the top 20 schools were European. The top American schools survive on the strength of vast endowments and lavish gifts from alumni. “We get 30-50% of our budget from gifts,” says Paul Danos, dean of the Tuck School of Business. “You lose money on every traditional MBA,” admits Tepper's Mr Dunn. “My guess is that no top MBAs cover their costs, because you need outstanding faculty to attract the students, and you need money to finance their research. You make it up out of endowment, gifts and contributions from companies.” David Tepper's donation of $55m to Carnegie Mellon persuaded the school to change its name.

At the other end of the scale are the universities of Phoenix and Webster, with modest entrance requirements and no expensive research staff to finance. The schools squeezed in the middle include those attached to American public universities, which often use their business schools as cash cows, creaming off some of the high fees that students pay.

And does it pay?

While competition grows, so does criticism. This is not for the first time: in the late 1950s, exhaustive reports by the Carnegie and Ford foundations complained about the inadequacies of MBA programmes. One described business administration, as taught in universities, as “a vague, shifting, rather formless subject”, a criticism that still holds in many schools.

However, business schools now find themselves criticised from several (sometimes conflicting) directions: for paying too much attention to the return on their students' investment, for example, and yet for not giving value for money; for being too academic, and for being too concerned with teaching basic practical skills.

The most commercially wounding criticisms are those that appear to contradict the claim that an MBA enhances career prospects. There was uproar when, two years ago, Mr Pfeffer and Christina Fong argued in *Academy of Management Learning and Education* that there was little evidence that getting an MBA had much effect on a graduate's salary or career. “Usually it just makes you a couple of years older than non-MBA peers,” one source told them.

Of course, business schools may be important mainly as a screening mechanism—their basic skill may be choosing students, not teaching them. Once in, and the vast bill paid, few are ever thrown out for failing their exams even though, as Mr Pfeffer and Ms Fong mischievously point out, they are much more likely to cheat than students in other disciplines.

Moreover, business schools certainly work extremely hard—much harder than other educational institutions—at getting their students into the job market. They employ squads of recruiters. Harvard, for instance, has 17 full-time staff and 24 part-time counsellors to help 900 students find glamorous jobs. Even if the school taught students nothing, they would still be buying the finest job marketing imaginable.

A different complaint is that business schools fail to teach their students the right things. The strongest advocate of this view is Henry Mintzberg, a professor at Canada's McGill University. In “Managers Not MBAs”, a new book, he argues that conventional MBA courses offer “specialised training in the functions of business, not general educating in the practice of management”. Their students are often too young and inexperienced to learn skills that, in any case, are often easier to acquire in the workplace than sitting in a classroom. “Conventional MBA programmes train the wrong people in the wrong ways with the wrong consequences,” he complains. They ignore the extent to which management is a craft, requiring zest and intuition rather than merely an ability to analyse data and invent strategies.

Maybe that is why, as Mr Mintzberg gleefully points out, a list of America's most-admired business leaders (Warren Buffett, Herb Kelleher, Michael Dell, Bill Gates, Jack Welch and Oprah Winfrey) contains not a single MBA. And that is in spite of the fact that a growing proportion of chief executives, at least in America, now has an MBA. A study by the Leadership Initiative at Harvard Business School found that about 10% of America's chief executives or founders of large companies had an MBA in the 1960s, compared with almost 60% in the 1990s. Some business schools seem to be trying to meet such criticisms. They have launched new courses that encourage students to learn to collaborate with each other and work in teams; they offer executive coaching rather than just lecturing; they create ambitious new courses in leadership. All are attempts to bridge the gap between the academic classroom on the one hand and the more practical, hands-dirty approach of commercial management development.

Roughly the reverse of Mr Mintzberg's complaint is the criticism advanced by Rakesh Khurana of Harvard Business School, who is writing a book on why management has failed to develop as a profession. He points out that other activities in which society prizes a sense of restraint, judgment and the pursuit of the common good, such as law, health care and religion, have evolved into professions. A surprising number of business schools, including Wharton in Pennsylvania and IESE in Barcelona, were founded by people who wanted to improve the ethical sensitivity of managers. (IESE, founded by Opus Dei, a Catholic organisation, still has religious statues and paintings in its principal rooms.) “At the heart of professionalism is the renunciation of certain things,” claims Mr Khurana. American managers have not obviously been keen on renunciation in the past decade.

But could business schools change this? Lots of them now offer courses on ethics, surely a key attribute of professionalism. Students are not always enthusiastic. Besides, whatever the ethicists say, the overall impact of a course may teach a different lesson. In 2002 the Aspen Institute surveyed 2,000 MBA students and found that their values altered during the course. By the end, they cared less about customer needs and product quality and more about shareholder value. Management research tells a similar tale. A study** last year of management research in economic and social contexts found far more emphasis on economic performance and objectives than on social goals.

A rather different complaint is that business schools are increasingly pulled in two directions. They want to teach students practical relevant skills. They want their research to come up with important, novel findings. But the gap between teaching and research grows ever wider.

In her presidential address to the Academy of Management last year, Jone Pearce of the Graduate School of Management at the University of California, Irvine, drew attention to the divide between the scholarly world of research and what she called “folk wisdom”: the insights conveyed in the classroom. “Many of us”, she told her fellow practitioners, “have created these two nearly parallel worlds as a way of coping with the conflicting pressures of conducting serious scholarship and the need to teach experienced managers who pay a lot of money to learn something useful.” Yet little of the folk wisdom drew on the findings of research or had undergone scholarly testing.

Part of the problem is the way that management research—like so many areas of knowledge—tends to explore ever more obscure topics as scholars seek out an unvisited niche. With reason, Ms Pearce is particularly baffled by so-called “critical management theory”. A description of this abstruse subject on the Academy of Management website announces that “Our premise is that structural features of contemporary society, such as the profit imperative, patriarchy, racial inequality and ecological irresponsibility often turn organisations into instruments of domination and exploitation.” Few are the companies happy to pay $50,000 for their top managers to learn that.

Pulling together research and teaching will be hard. “You are starting to get splits,” reports Roy Lewicki, editor of *Academy of Management Learning and Education*: “Contract faculty teach, and tenured faculty mainly do research and are better paid.” Perhaps the professionalisation of management teaching, recommended by those two reports of the late 1950s, has now gone too far. Perhaps management education would beat off its critics more effectively if it went back to its beginnings, and got more corporate managers to teach. It might be easier to train them to communicate properly with students than to get professional management academics to teach students to be good managers.

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* “Changes in Graduate Management Education and New Business School Strategies for the 21st Century” by Paul Friga, Richard Bettis and Robert Sullivan. *Academy of Management Learning and Education*, 2003, Vol. 2, No. 3

† “The Business School ‘Business’: Some Lessons from the US Experience” by Jeffrey Pfeffer and Christina Fong. Forthcoming in the *Journal of Management Studies*

** “Social Issues and Management: Our Lost Cause Found” by James Walsh, Klaus Weber and Joshua Margolis, *Journal of Management*, 2003

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Oil

Pain at the pump

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AP

Is the recent rise in oil prices cause for alarm?

NOT everyone is suffering from higher oil prices: the price of crude oil has been above $40 a barrel for more than a week and shows no sign of falling back, so the Organisation of Petroleum Exporting Countries (OPEC) will reap billions of dollars of extra profit. Consuming countries, needless to say, are worried, even angry. Prices have not been this high, in nominal terms, since they spiked in 1990, at the time of the first Gulf war. Is oil about to knock the world economy off course?

Energy ministers from the chief consuming countries are sure to make their fears plain when they meet their OPEC counterparts in Amsterdam on May 22nd. Anticipating trouble, the cartel's ministers have already signalled that they are likely to agree to increase production quotas this weekend. Whether this will really mean more and cheaper oil remains to be seen. Although OPEC can call forth more oil, it is not the only influence on price—or, just now, the most important.

Nor is it clear, despite the high prices that Americans must pay (by their standards) to fill their cars, that $40-a-barrel oil is doing much economic harm—so far, anyway. After all, in the past couple of years the global economy has gone from lethargy to lusty growth. Indeed, that growth is one cause of the rise in the price of oil.

One reason not to worry too much is that in real terms the price is well below past peaks. In today's money, oil prices hit nearly $60 a barrel at the time of the first Gulf war and topped $80 a barrel in the late 1970s. A second reason is that rich economies are less energy-intensive than they used to be. America, for example, uses only half as much oil per unit of GDP as it did three decades ago. This is chiefly due to a shift away from manufacturing to services, which are less energy-intensive. In Europe and Japan, energy taxes have also spurred efficiency. Petroleum's share of OECD commodity imports, in value terms, plunged from 13% in the late 1970s to just 4% in the late 1990s.

That said, industries such as chemicals and aviation are being squeezed: a robust recovery reported this week by British Airways, for example, is threatened by rising jet-fuel prices. Many developing countries are being hit hard. The International Energy Agency (IEA) says that their economies are more dependent on imported oil and more energy-intensive than rich

countries', and that they use energy less efficiently. On average, poor countries use twice as much oil per unit of GDP as OECD countries do (see chart).

Analysts at Goldman Sachs say that today's oil prices are now entering “a danger zone” even for rich countries. They reckon that if prices stay at current levels for a few more months America's GDP growth rate will cool to 3% or so by 2005. That is no catastrophe, but high oil prices will nonetheless feed inflationary expectations (see article) and will have much the same effect on the economy as a tax increase.

The real worry is not the current price, but the thought of a further rise. What if the price goes higher still, say to $50 or beyond? That would be worse news, for sure. The hard bit is working out how much worse. The rate of change will probably matter: a slow climb would hurt less than a sudden leap. The link between oil prices and growth might not be linear. A move from $20 to $40 has not choked the global economy; another $20 rise, to $60, might.

To assess the chances of a further increase, it helps to know what has driven the price to its current level. Typically, OPEC bears most responsibility for oil-price increases. Equally typically, it tries to pin the blame elsewhere. This time, it is pointing at the futures markets. Alí Rodríguez, a former head of OPEC and current boss of PDVSA, Venezuela's state-run oil firm, insists: “The market is well supplied. This $40 price is not related to fundamentals: it's due to speculation.”

This may be self-serving, but it is half-right. Nearly all OPEC members (but not Saudi Arabia, by far the biggest producer) are cranking out about as much oil as they can. And there truly is a speculative frenzy going on. Trading of crude-oil futures on the New York Mercantile Exchange (NYMEX) has been near record highs recently, with most bets placed on higher prices.

Underneath the speculation, though, lie two other factors: demand and fear of terror. A factor that was not present in past periods of price pressure is that demand from China has been surging. There is a chance that this will prove temporary, especially if Chinese officials' efforts to cool down the economy are successful, or if, as some think, the Chinese boom cannot be sustained. More important, though, the importance of Chinese demand may have been overstated. Though growing fast, China's thirst for oil still pales in comparison with America's.

America, which consumes one-quarter of the world's petroleum, remains the world's largest oil user by far. Most of that oil goes into Americans' cars, as petrol. Demand is strong; the summer “driving season” is at hand; and America's oil infrastructure has some severe bottlenecks. Because of a hodgepodge of environmental regulations, the country's petrol market is balkanised. The industry has had to develop lots of “boutique” fuels to meet local requirements. This makes it hard to ship fuel easily from state to state, and contributes to local shortages. Worse, this year there have been unusual maintenance problems at refineries.

Explosive cocktail

Throw all this together, and you get a perfect formula for high prices. Eric Bolling, a trader on the NYMEX, argues that the domestic petrol squeeze is the main cause of the recent rise in global oil prices. “This is the tail that's wagging the dog,” he says. Philip Verleger, a veteran energy economist, agrees: “Nothing the Saudis do or announce would affect crude prices until the gasoline bubble pops.” Then, he thinks, prices could plummet to $20 a barrel.

The terror premium, however, points in the other direction. The chief worry is that political unrest in the Middle East may disrupt oil supplies for some time, and thereby deal a powerful blow to the world economy. This is thought to contribute some $4 to $8 a barrel at the moment. One area of concern is Iraq, where repeated sabotage of the chief export pipeline to the north has disrupted the country's return to the world market. Now terrorist attacks are also taking place in the south, the source of two-thirds of Iraqi oil. The continuing political difficulties in Venezuela, where opponents of President Hugo Chávez shut down the oil industry in 2003, also makes traders jittery.

But the biggest fear by far is that terrorists might strike energy targets inside Saudi Arabia. This was once unthinkable, but recent weeks have seen precisely such attacks. Saudi Arabia matters not only because it is the largest exporter of oil: it also happens to be the only country with lots of idle capacity. The Saudis have used this to export oil quickly whenever there is a sudden drop in production—during the first Gulf war, for example, and during Venezuela's crisis last year.

But what happens if Saudi output itself is severely disrupted? “The world markets alone cannot withstand the loss of Saudi Arabia,” says Claude Mandil, the head of the IEA. “That is why we have IEA stocks. We are ready.” Perhaps, but given constraints on the speed at which strategic stocks can be drawn down, that assertion depends entirely on how much Saudi output might be knocked out.

The oil price is therefore on a razor's edge. There is less spare capacity available today than at almost any time in the past 30 years, so prices could rocket if demand stays high and capacity is lost to terrorism. At the same time, there are signs that the run-up in American petrol prices is already affecting demand—sales of SUVs are down, for example—suggesting that prices could yet even fall. Still, this weekend's meeting in Amsterdam does matter. Saudi Arabia's oil minister says he wants moderate prices; he might even mean it. Getting there smoothly will not be easy.

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America's economy

Time to worry, Mr Greenspan?

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AP

The rise in America's inflation rate is more than a blip, but not a problem—yet

Get article background

YOU see it at the gas station; you might notice it again when you buy clothes or check into a hotel. The statistics, apparently, bear it out: prices in America are rising, and faster than economists expected. To most Americans, the sky-high price of petrol may be the clearest sign of what is happening. But it is the recent increase in core inflation, which excludes the volatile prices of fuel and food, that has economists worried.

To be sure, the inflation rate is still low. The core consumer-price measure has risen from 1.1% in January to 1.8% in April. The rate is scarcely high enough to give central bankers palpitations. Still, the acceleration has been brisk. At an annualised rate, core inflation for the first four months of the year was 3%.

This is not the product of one or two errant statistics. Virtually every one of America's many inflation gauges—consumer prices, the personal consumption expenditure deflator, producer prices—is shifting upwards. Within each of these indices, the moves are broadly based. In the consumer-price index, for instance, the imputed cost of housing and the prices of hotel rooms, clothes and medical care are the main sources of the overall jump. Look carefully, says Richard Berner of Morgan Stanley, and you will see even broader evidence that goods prices are falling more slowly and that some services prices are rising more quickly than before.

The cause is not obvious. A cheaper dollar and stronger commodity prices, including energy prices, are likely factors. After months of absorbing these in their margins, firms are finally passing on some of the increase in their costs. If this is the main reason why core inflation has risen, then there is little cause for concern. Shifts in commodity prices and currencies tend to be one-off effects, not the source of enduring inflationary pressure. Better yet, the dollar has been strengthening recently and the prices of commodities other than oil have been falling.

The pricing-power puzzle

Many economists, however, are not sure that this is the whole story. Not long ago, the prices of everything from cars to hotel rooms were being deeply discounted. Now it seems that pricing power is

returning. The oddity is that this is happening in an economy that, although growing rapidly, still has plenty of slack according to the usual measures. Despite recent job gains, the unemployment rate stands at 5.6%. Industrial capacity utilisation is 76.9%. Both numbers indicate an economy some way from full capacity, so why is inflation rising? Possibly, summary statistics such as the jobless rate or factory utilisation rate are too crude to capture the true degree of slack. Moreover, it is not just the amount of slack that matters, but also the speed at which it is being taken up.

Is this enough to worry about? Many on Wall Street think so: it is a sign, they say, that America's central bank has left interest rates too low for too long. Alan Greenspan may be popular at the White House (on May 18th he was nominated by George Bush for a fifth term as chairman of the Federal Reserve) but he is said to be “behind the curve”. Before long, on this view, price pressures will get out of hand and interest rates will need to rise faster and higher than they would have done had the Fed acted sooner. Mr Greenspan and his crew, in contrast, appear sanguine. At its most recent meeting, on May 4th, the interest-rate-setting committee talked only about raising interest rates at a pace that “is likely to be measured”.

It is too early to tell whether the worrywarts are right. Much depends on two unknowns: the strength of productivity growth and the impact of modestly higher prices on inflation expectations. Until now, soaring productivity growth has been driving down firms' unit labour costs at a record pace—an annualised 1.6% over the past nine quarters—according to Morgan Stanley's Mr Berner. Inflation, he points out, has never risen meaningfully when unit labour costs are falling.

In the first three months of 2004, unit labour costs rose, but by only 0.5%. This is not nearly enough to set alarm bells ringing. Were productivity growth to fall sharply, that could change. Because American companies are currently enjoying extremely fat profits, they could probably absorb some costs in thinner margins, as Mr Greenspan has remarked. But lower productivity growth would eventually imply higher inflationary pressure.

Another problem would arise if higher inflation became engrained in people's expectations. If workers and firms expect inflation to increase, they seek higher wages and prices in anticipation. Financial markets clearly think inflation will rise: the expected inflation rate implicit in the differential between inflation-protected Treasury bonds and the ordinary type has widened substantially.

Consumers seem to be far more worried about inflation in the short term than in the more distant future. Surveys by the University of Michigan suggest that consumers expect inflation to rise to 3.2% in the year ahead, largely because of oil prices. They expect inflation to be higher in the longer term too, but still to stay within the broad range of the past few years. They could become more pessimistic, however, especially if the increases in petrol prices are prolonged.

Put all these factors together, and the increase in America's inflation rate amounts to more than a blip. It is probably not yet a problem, either, but the challenge for Mr Greenspan and his colleagues is to make sure it does not become one.

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Japan's economy

Economic tonic

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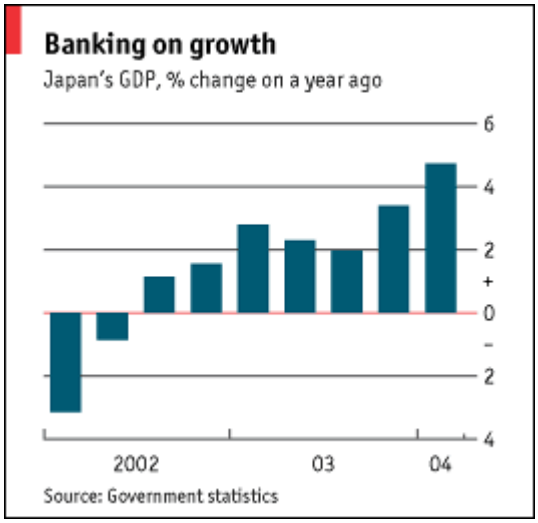
Strong growth data provide great news for the country's banks

Get article background

FIRST came a loud, worrying echo of old troubles. On May 17th, the Tokyo stockmarket tumbled by 3.2% on word that UFJ, Japan's fourth-biggest banking group, would have to revise its earnings downwards for the second time in three weeks—this time, into the red. Bank shares, which have done especially well in the past year, fell more sharply. The next day, though, came the latest evidence that the economy is on the mend: it seems that GDP grew even more quickly in the first quarter than most economists had expected. The market took heart. On May 18th and 19th the Nikkei 225 enjoyed a climb of 4.4%, its biggest two-day gain since last July. Bank shares also recovered their poise.

In recent months Japan's banks have been looking healthier than for many years. Their bad loans seem finally to be getting sorted out. The strengthening economy, which has improved the lot of many borrowers, has helped in no small measure. However, UFJ, which with Japan's other big banks will publish its earnings next week, is clearly struggling to become profitable. In late April, the bank lowered its earnings estimate for the year that ended in March from ¥210 billion ($1.8 billion) to ¥78 billion, as its expected charges for bad loans mounted. The trouble this week stemmed from reports that UFJ will have to set aside much more because its problems with loans to many big borrowers are worse than advertised. It may have made a net loss of ¥300 billion or more. Top managers may now have to resign.



Despite this salutary reminder that the banks' balance sheets ought still to be looked at sceptically, the economy's recent good run means that their bad-debt problems look much more manageable than they did even six months ago. Real GDP rose by 5.6% at an annualised rate in the first quarter; it was 4.7% higher than a year before (see chart). It has now expanded for eight quarters running. At 3.2%, real growth in the year to March was the best for seven years.

Perhaps the most encouraging aspect of the growth data was evidence of stronger domestic demand. Hitherto, the recovery has been founded on exports and corporate investment, but its base now seems to be broadening. Private consumption rose at an annual rate of 4% in the first quarter, accounting for more than one-third of the increase in GDP. Investment in housing also rose nicely. This suggests that Japanese households are growing more confident, despite another year of falling wages. A recent drop in the unemployment rate, to 4.7%, may have boosted their spirits a bit.

Many economists still worry that any revival in consumer spending will prove short-lived if demand from China and America slows. Strong export growth has contributed to a rapid rise in corporate profits, from which everything else in this recovery has flowed. Higher profits at big manufacturers, for example, have boosted capital investment, with knock-on benefits for other companies. The mood of optimism now seems to have reached consumers too.

For the time being, the data are good—both for the economy as a whole and for the banks specifically. Troubled borrowers' cashflows are improving. Companies that are already healthy might even begin to borrow again. The results that the banks publish next week will provide a useful snapshot of how far they

have come in the past year. But the best guide to their prospects lies in those economic figures.

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The cost of AIDS

An imprecise catastrophe

May 20th 2004 | JOHANNESBURG
From The Economist print edition

Economics and an epidemic

THE most dreadful cost of AIDS is in lives lost. A second cost, shared by those not infected, is economic. However, estimating the damage done by the disease, especially in southern Africa's mostly feeble economies, is an inexact exercise even by the standards of economics, because AIDS has struck hardest in areas where data are least accurate: subsistence farming, casual labour markets, rural barter and so forth.

A report presented, in its final draft, on May 20th by British parliamentarians and the Royal African Society draws together the findings of various recent studies and experts' testimony. It concludes, alas, that the most realistic estimates of the economic impact of AIDS are also the most pessimistic. The disease, it reckons, is already depressing sub-Saharan Africa's annual GDP growth rate by 0.8 percentage points. In the worst-hit countries, where more than one-fifth of adults have HIV, the burden is 2.6 points.

This is necessarily an estimate. Still, a qualitative description of the costs makes their scale plain enough. Southern Africa's economies depend on farming. Because AIDS kills more women than men, and because women do more farming and run households, food insecurity is rising. HIV infection means other diseases spread faster. Patients may be too feeble to farm effectively. The report argues that the region's food shortage in 2002 was especially acute because so many young adults were too sick to work or to travel for help. Less productive grandmothers ended up caring for families or struggling to farm.

AIDS distorts spending and eats away at savings: money goes on health care, traditional ceremonies and funerals. Last year in Zimbabwe, the average expenditure on a funeral was $105. On average, patients are too sick to work in the six months before death, while the cost of care surges.

The costs go beyond rural agriculture. Roughly one-third of some 1,000 South African companies surveyed last year reported that AIDS had damaged their profits. Perhaps surprisingly, it has not caused a run-up in wages (by making labour more scarce), but it is pushing up other labour costs. Staff are absent (sick or at funerals); morale is low; jobs go unfilled; training costs are higher. Some South African firms and multinationals now offer anti-retroviral drugs to employees. Distributing them safely is costly; the alternative, though, is to let workers fall sick and die.

Maybe governments should think the same way. Africa's richest country, South Africa, is only this year beginning to provide anti-AIDS drugs at a few dozen public clinics. Its government estimates that AIDS could slice roughly a percentage point off annual GDP growth. It is expensive to treat sick doctors, accountants, civil servants, teachers and other skilled workers, but it may be cheaper than waiting for a new generation, many of them orphans of AIDS and poorly educated, to be trained. And this only adds to the moral case for treatment.

At times rich countries' help seems a mixed blessing: this week the Bush administration insisted that anti-AIDS drugs America buys for poor countries must be vetted by the Food and Drug Administration, even if they already meet the requirements of the World Health Organisation. What more could the rich do? Give more aid, for a start, says the report—especially to train replacements for the many African doctors and nurses who emigrate to richer countries every year. A softer line from the IMF on spending would help too. Maybe anti-AIDS drugs bought with aid money could be manufactured in Africa, to help the continent's economies. None of this would stop the epidemic, but it might lessen its impact.

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German IPOs

Slow bicycle race

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From The Economist print edition

A bike manufacturer shows the way to market

AN EAST GERMAN bicycle-maker came first this week in a race that no one else seemed to want to win. On May 17th its shares were floated on the Frankfurt bourse, in Germany's first initial public offering (IPO) for two years. Flotations by two silicon-chipmakers, X-Fab and Siltronic, had been cancelled at short notice in March. The bicycle company pedalled steadily to the front.

The shares of Mitteldeutsche Fahrradwerke, whose antecedents began making bikes in the town of Sangerhausen in 1907, have been trading in lots as small as three shares. The share price, €9.30 ($11.10) at issue, has stayed upright, at above €9.50.

A bigger test came on May 19th with the flotation of Wincor Nixdorf, a maker of automated cash machines. The company, once a division of Siemens, raised €327m, of which it kept €102m. The rest went to Kohlberg Kravis Roberts and Goldman Sachs Capital Partners, private-equity companies that bought the company in 1999. On the first day of trading the shares rose slightly from their initial price of €41.

This is encouraging news for Postbank, Germany's biggest retail bank, owned by Deutsche Post. On June 21st Postbank is due to float just under half of its shares, hoping to raise around €3 billion. Still, only if that is successful can dealers be sure that the Frankfurt stockmarket is back in business as a place for companies to raise capital. The last IPO of comparable size raised €913m for Fraport (owner of Frankfurt airport) in June 2001.

German retail investors are more tempted by short-term bets on financial warrants and derivatives than they are by shares. Recently they have been trading between €15 billion-worth and €19 billion-worth a month, either with banks or on the Frankfurt and Stuttgart exchanges, according to Deutsche Bank. The market is still growing: last year, the biggest so far, monthly trade averaged €13 billion. Long-term investors in shares have lost half their money or more on nearly all of the big IPOs in Germany in the past five years. Will Wincor Nixdorf and the bike-makers of Sangerhausen reverse that trend?

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Online payments

Paying through the mouse

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PayPal is turning into a huge online-payments business

ONE of the most powerful forces in e-commerce is the “network effect”: the more people who flock to a particular website, the greater its appeal. The latest beneficiary of this phenomenon is PayPal, which now handles online payments at an annualised rate of more than $17 billion. PayPal is not a bank, but for online buyers and sellers it performs much the same function. It already has 45m account-holders worldwide, one-quarter of the number of the mighty Citigroup.

The company began in Silicon Valley in 1998. Its e-mail system for payments became so widespread on internet auction sites that the biggest firm in this business, eBay, set up a rival, Billpoint, in the hope of snaffling for itself some of the value of transactions. But Billpoint never matched PayPal's popularity, so in 2002 eBay bought PayPal for $1.5 billion in shares.

Next time, online

PayPal's ambition is to become the global standard for internet payments and it is expanding overseas in eBay's footsteps. In the first quarter of 2004, the value of items sold on eBay was $8 billion, 51% more than a year earlier. Meg Whitman, eBay's chairman, told analysts recently that the company reckons one in three online shoppers in America now has a PayPal account.

Although PayPal's customers mostly buy via eBay, usage elsewhere is also growing—estimated at well over $1 billion-worth of transactions in the first quarter of the year. Besides purchasing from other dotcoms, you can pay your taxes in York County, South Carolina or send a donation to the Pat Brody Shelter for Cats in Lunenburg, Massachusetts. PayPal also does gift vouchers.

The payment mechanism is simple enough. Newcomers to PayPal provide details of a credit card or bank account. These are verified with a nominal transaction. Thereafter, a buyer can e-mail a payment directly to a seller. This is immediately debited from the buyer's credit card or bank account, and a credit is made to the seller's PayPal account. Money in a PayPal account can be withdrawn by cheque or transferred to a bank account. Individuals and small traders can receive credit-card payments without obtaining a merchant account. PayPal's cut comes from charging recipients between 2.2% and 3.4%, depending on the country, and levying fees for currency conversions. In the first quarter of 2004, PayPal's revenues were $155m, 69% more than a year before.

PayPal has helped slash the time internet users spend completing transactions and has greatly increased confidence in trading online, says Matthew Bannick, the company's general manager of global payments. It can take several weeks for cheques to arrive in the post and for payments to clear, but online payments are made instantly, which means goods can be shipped straight away. “It has improved the velocity of trade,” adds Mr Bannick.

Another benefit, he says, is that buyers do not have to impart banking or credit-card information to merchants. Security remains the prime concern of internet shoppers. An NOP survey that PayPal commissioned in Britain, where the company opened its first overseas site last year, found that more than one-third of internet users are reluctant to spend more than £50 ($90) online. To overcome their concerns, payment protection is now offered in America (up to $500) and in Britain (up to £250) on goods sold by eligible traders (those who have built up good reputations within eBay's ranking system). This now covers more than 60% of all listings on eBay's American site.

PayPal wants to expand internationally, to continental Europe and Asia. Although it has not said so, the likeliest next local site is Germany; China, eBay's fastest-growing market, looks like a good long-term possibility. Such growth will bring new challenges. People in different countries favour different ways of making payments offline: the French like cheques, for instance; in Germany, bank transfers are common. This might translate into different online habits. Countries also regulate financial services differently.

PayPal has no plans, though, to become a bank, even though it performs some similar functions. Customers in America can earn interest on their PayPal balances by allowing PayPal to place the funds in a pooled savings account or by enrolling into PayPal's money market fund. It has been licensed as a money-transmitter in American states and in Britain. Regulation as a bank would require more costly and complicated compliance.

Nevertheless, the company has faced regulatory challenges, not least because it could be used for the illicit transfer of funds. Soon after it acquired PayPal, eBay ended its services to online gambling merchants because of complaints from federal prosecutors that this violated America's Patriot Act, which Congress passed after the September 11th terrorist attacks to harden money-laundering rules. Last year, eBay paid $10m to settle the charges.

Because most of its payments are small, big sums stand out. This should help PayPal comply with the authorities. Now it is interested in handling even smaller amounts. Late last year it introduced lower processing fees for micro-payments, to make it more feasible for online merchants to accept tiny payments for digital-music downloads. The success of portable music players, such as Apple's iPod, suggest that this too will be big online business.

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Economics focus

Slackers or pace-setters?

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Monopolies may have more incentive to innovate than economists have thought

A LOT of attention has been paid to the ill effects of monopoly. Economists long ago pointed out why it is bad for a single firm to dominate a market. In essence, the trouble with monopolists is that they can set prices almost as they please. Unlike in competitive industries, a monopolist's price, in the jargon, can be way above the marginal cost of production. Worse, immunity to competition makes a monopolist fat and lazy. It needn't worry too much about keeping customers happy. Worse still, if a company has no fear of competition, why should it bother creating new and better products?

By and large, officialdom these days continues to take a dim view of monopoly. Antitrust authorities in many countries do not shrink from picking fights with companies that they believe are too powerful. The biggest target in recent years, first in America and now in Europe, has been Microsoft, creator of the operating system that runs on some 95% of the world's personal computers. One of the arguments against Microsoft is that its dominance of the desktop allows it to squeeze out smaller and (say the company's critics) more innovative rivals.

Despite this, compelling evidence that monopolists stifle innovation is harder to come by than simple theory suggests. Joseph Schumpeter, an Austrian economist, pointed out many years ago that established firms play a big role in innovation. In modern times, it appears that many product innovations, in industries from razor blades to software, are made by companies that have a dominant share of the market. Most mainstream economists, however, have had difficulty explaining why this might be so. Kenneth Arrow, a Nobel prize-winner, once posed the issue as a paradox. Economic theory says that a monopolist should have far less incentive to invest in creating innovations than a firm in a competitive environment: experience suggests otherwise. How can this be so?

One possibility might be that the empirical connection between market share and innovation is spurious: might big firms innovate more simply because they are big, not because they are dominant? A paper* published a few years ago by Richard Blundell, Rachel Griffith and John Van Reenen, of Britain's Institute for Fiscal Studies, did much to resolve this empirical question. In a detailed analysis of British manufacturing firms, it found that higher market shares do go with higher investment in research and development, which in turn is likely to lead to greater innovation. Still, the question remains: why does it happen?

A new paper† by Federico Etro, of the University of Milan, aims to resolve Mr Arrow's paradox. He sets out a model in which a market leader has a greater incentive than any other firm to keep innovating and thus stay on top. Blessed with scale and market knowledge, it is better placed than potential rivals to commit itself to financing innovations. Oddly—paradoxically, if you like—in fighting to maintain its monopoly it acts more competitively than firms in markets in which there is no obviously dominant player.

The hunted monopolist

The most important requirement for this result is a lack of barriers to entry: these might include, for example, big capital outlays to fund the building of new laboratories, or regulatory or licensing restrictions that make it hard for new firms to threaten an incumbent. If there are no such barriers, a monopolist will have an excellent reason to innovate before any potential competitor comes up with the next new thing. It stands to lose its current, bloated profits if it does not; it stands to gain plenty from continued market dominance if it does.

If the world works in the way Mr Etro supposes, the fact that a dominant firm remains on top might actually be strong evidence of vigorous competition. However, observers (including antitrust authorities) may well find it difficult to work out whether a durable monopoly is the product of brilliant innovation or the deliberate strangulation of competitors. More confusing still, any half-awake monopolist will engage in some of the former in order to help bring about plenty of the latter. The very ease of entry, and the aggressiveness of the competitive environment, are what spur monopolists to innovate so fiercely.

But what if there are barriers to entry? These tend to make the dominant firm less aggressive in investing in new technologies—in essence, because its monopoly with the existing technology is less likely to be challenged. Over time, however, other companies can innovate and gradually overcome the barriers—"leapfrogging", as Mr Etro calls it. Meanwhile, the monopolist lives on marked time, burning off the fat of its past innovations.

So much for theorising. What might the practical implications be? One is that antitrust authorities should be especially careful when trying to stamp out monopoly power in markets that are marked by technical innovation. It could still be that firms like Microsoft are capable of using their girth to squish their rivals; the point is that continued monopoly is not cast-iron evidence of bad behaviour.

There might be a further implication for patent policy. Patents, after all, are government-endorsed monopolies for a given technology for a specified period. Mr Blundell and his colleagues found that the pharmaceutical industry provided the strongest evidence of correlation between market share and innovation. Thus strong patents, despite their recent bad press, can be a source of innovation. Generally, though, when one company dominates a market, people should be careful in assuming that it is guilty of sloth. It may be fighting for its life.

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* "Market Share, Market Value and Innovation in a Panel of British Manufacturing Firms". *Review of Economic Studies*, 1999.

† "Innovation by Leaders". *Economic Journal*, April 2004.

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Dog breeds

Pedigree chums

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ARDEA

The family tree of the domestic dog has now been laid bare

DOGS are the most diverse animals created by the hand of man. Even the fancy pigeon breeds that helped Darwin gain insight into the process of natural selection do not approach them in variety of form. Yet the origins of those forms are, in many cases, obscure. None of the pedigree books that define modern breeds goes back earlier than the mid-19th century.

Those breeds, however, are of more than just amateur interest. The closed-book rules of kennel clubs around the world mean that recognised breeds tend to become more and more inbred, exposing genetic defects that outbreeding would cover up. That is bad for dogs, but good for medical science, as Elaine Ostrander, of the Fred Hutchinson Cancer Research Centre, in Seattle, recognised several years ago.

Many genetically linked diseases—including heart disease, several forms of cancer, epilepsy and some sight and hearing defects—that are found in dogs, are found in people, too. This fact, when combined with modern genetic techniques and the knowledge of individual relationships recorded in the pedigree books, means that the genes responsible for those diseases are likely to be easier to locate in dogs than in people—which Dr Ostrander has already done for some cancer genes.

The reason for doing this is that locating a dog-disease gene makes it easier to find that gene in people. It is simply a question of looking in the corresponding piece of human chromosome. So, partly for curiosity, and partly to help her medical work, Dr Ostrander embarked on a project to understand dog genetics better by tracking down the true pedigrees of pedigree dogs. Her results appear in this week's *Science*.

Dogone!

Surprisingly, given the interest in their pedigrees, little work has been done on the recent genetic history of dogs. The origins of the species have been investigated over the past few years, and that has confirmed what most people suspected: dogs are domesticated wolves. However, the technique used to reach back to those ancestral wolves, which relies on so-called mitochondrial DNA that is passed from mother to offspring independently of the main nuclear DNA, is too crude to pick out the details of recent dog history. For that, Dr Ostrander and her colleagues used two other genetic tricks: single-nucleotide polymorphisms and microsatellites.

These are both small, variable pieces of nuclear DNA that can be tracked from one individual to another. The number of them that two animals have in common is a measure of how closely related they are. And exactly which of them are shared between different individuals in a sample can, with the application of a bit of computing power, yield a reasonably reliable family tree. Which is what Dr Ostrander has provided, for dogs from 85 breeds.

There is more than one way to do this sort of genetic analysis, though, and the outcome is obviously more believable if the results from different techniques agree. Dr Ostrander used two techniques, and they did seem to agree.

Her first analysis employed a technique called neighbour joining. This produces an actual family tree, but goes to pieces relatively quickly. Neighbour joining suggests that the dog world is divided into five branches. Four of these represent groups of what look like ancient breeds. The fifth represents the rest of dogdom.

The oldest branch revealed by neighbour joining comprises four Asian spitz-type dogs: the shar-pei, the shiba inu, the Akita and the chow chow. The second branch is the basenji, an African breed. The third consists of the Alaskan malamute and the husky, and the fourth contains the Afghan and saluki hounds.

Distinguishing the relationships between the dogs in the fifth branch is much harder. That probably reflects their more modern origins. But the second technique, which used a branch of mathematics called Bayesian logic, was able to make sense of the fifth branch, at the expense of collapsing the other four into a single group and adding a further seven Asian and African breeds to it. That is, in part, because such a Bayesian analysis can only divide a sample into groups; it cannot tell you anything about what is going on inside those groups. It cannot, in other words, yield a family tree that has a breed at the end of every twig.

By throwing some wolf genomes into the Bayesian analysis, Dr Ostrander was able to show that the Afro-Asian group was the closest to the ancestral wolf: wolf genomes from eight different places clustered with the Afro-Asian breeds. There were some surprises, though. Pharaoh hounds, which resemble the dogs from ancient Egyptian tomb paintings, and were assumed to have descended more or less unchanged from the hunting dogs of the Egyptian aristocracy, turn out not to be part of the Afro-Asian group. They belong to a modern group, as do Ibizan hounds, also thought to be ancient.

The Bayesian method suggested that family relationships in the rest of dogdom go back to the days when dogs had to work for a living, rather than being pampered pets. When pushed to divide the canine world further, it came up with three groups besides the ancient Afro-Asians.

Hunting dogs, including bloodhounds, terriers, spaniels, pointers and retrievers, fall out of the analysis together, even though their roles in the hunt are very different from one another. Herding dogs, such as the collie and the Shetland sheepdog clustered, too—though this group included greyhounds and St Bernards. Perhaps the rounding up of errant Alpine travellers is a distant relict of gathering sheep. The bulldogs, mastiffs and German shepherds also cleaved together.

How much this analysis will help Dr Ostrander's medical work remains to be seen. At the least, it should yield insights into when particular disease mutations arose. It might also help illuminate the origins of behavioural differences between breeds, and thus provide insight into a delicate topic, the genetics of behaviour. But regardless of its practical applications, it is surely an interesting insight into the evolution of man's best friend.

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Materials science

Light, and magic

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A new material may herald a breakthrough in electronic plastics

AP

The final days of dead-tree displays?

FOR years, researchers have been trying to craft electronic circuits that use plastic instead of metal to carry the current. Such circuits would be flexible, which would bring many advantages. They could, for example, form part of “electronic paper” displays that would be light and foldable—unlike existing liquid-crystal displays, which are heavy and rigid. Unfortunately, most known conducting polymers do not disperse in liquid solvents, and so cannot be made into products as easily as their workaday, non-conducting cousins are turned into drinks bottles and baby rattles.

Brian Elliott of TDA Research, a firm based in Wheat Ridge, Colorado, hopes to change that. His starting point is an electrically conducting polymer called polyethylenedioxythiophene, or PEDOT, for short. This molecule is an exception among conducting polymers in that it can be dispersed in a liquid solvent. It is thus already deployed in first-generation electronic-paper displays. It is, however, less than ideal, since the liquid concerned is water—an extremely reactive chemical that can cause corrosion during the manufacturing process, damaging the product.

To produce a polymer that can be dispersed in inert solvents, Dr Elliott took ethylenedioxythiophene, the building block “monomer” from which PEDOT polymer is made, and tweaked it. A PEDOT polymer-molecule is formed by linking the centres of the monomer molecules one to another. Dr Elliott realised, therefore, that the solution to the dispersal problem lay at the ends of the monomers—the parts of the assembled PEDOT chain that are exposed to the outside world. Tweak these appropriately, and modified PEDOT might disperse in non-corrosive solvents.

And so it came to pass. Dr Elliott will not say exactly what tweak he employed: that is a trade secret. But it involves capping the ends of the monomers with special, non-conducting molecules. The new polymer, dubbed Oligotron (a more precise scientific name would be too long to pronounce and, more importantly, would give its composition away) can be dispersed in non-corrosive industrial solvents such as acetone, propylene carbonate and nitromethane, making it ideal for manufacturing.

Nor does the magic end there. The caps themselves can be modified by having various adapter molecules attached to them, resulting in versions of Oligotron that have different applications. For example, Dr Elliott attached photo-sensitive adapter molecules to the caps. When exposed to ultraviolet light, these particular adapter molecules cross-react, causing the plastic to harden. This means that Oligotron circuits can be built up by a process similar to the photolithography used to make existing computer chips.

As Dr Elliott recently demonstrated to America's National Science Foundation, a suitably patterned ultraviolet light source can “print” a conducting-polymer circuit on a surface covered with this version of Oligotron. Areas exposed to the light harden and stick to the surface. The polymer in unexposed areas can then be washed away.

Oligotron attached to other adapter molecules can be used to make chemical sensors (the adapter reacts with the substance to be sensed, and this changes the conductivity of the Oligotron) and the active ingredient of solar-cells, which convert the sun's rays into electricity. That would make Oligotron light and magic in more ways than one.

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About sponsorship

Cultural evolution

Moniker's progress

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The names that parents give their children illuminate cultural evolution

HAD Apple Blythe Alison Martin—the offspring of a celebrity couple, Gwyneth Paltrow and Chris Martin—been born a boy, it is quite possible she would have had been given something of a more normal name. This suggestion arises from research into changing fashions in children's names, published in the *Proceedings of the Royal Society*. Alexander Bentley, of University College, London, and his colleagues are studying the mathematics of cultural transmission. For this sort of work, birth records—which contain every instance in a country of one sort of cultural object, namely people's first names—are a particularly good source of data.

Dr Bentley looked at the frequencies of different first names in American babies. One of his findings was that the "mutation rate" in names is higher for girls than for boys. Parents, in other words, are more liable to be inventive when choosing a name for a baby girl. The researchers have found that for every 10,000 daughters born in America there is an average of 2.3 new names. For sons, the figure is 1.6.

Dr Bentley is not sure why this is the case. One possibility is that in a society where family names are inherited patrilineally, parents feel constrained by tradition when it comes to choosing first names for their sons. As a result, boys often end up with the names of their ancestors. But when those same parents come to choose names for their daughters, they feel less constrained and more able to choose based on style and beauty.

Such tendencies, however, do change with the times. Novelty in names, as defined by new names entering the list of the top 1,000 American names, was high for both sexes in the 1970s, went down in the 1980s, and then increased in the 1990s. This increase was especially notable in boys' names (eg, Jaden). During the 1990s, there were 184 new boys' names on the list, the largest number of any decade of the 20th century. Dr Bentley speculates that this may be because patriarchal naming customs are declining, and because Old Testament names (Jacob, Noah) are replacing those from the New (John, Paul).

Overall, the pattern of children's names resembles the mathematical pattern that would be produced by random copying. One consequence of this is that most names are found at low frequencies (Hannibal, Eustace, Phoenix). Only a handful (John, David, Christopher) are common.

Changes in frequency often seem to be random, too. There is, of course, a celebrity effect—which is why the world is blessed with more Britneys than it used to be. But that does not explain the rise of Tyler, which first appeared in the top 1,000 in the 1950s, and reached the top ten in 1992.

Though fashion in names is a particularly good example of the phenomenon, Dr Bentley is finding that random copying seems to drive many forms of cultural change, from patterns on ancient clay pots to preferences for breeds of dog.

For some, this is disappointing. Many students of cultural evolution hope to find analogies with biological evolution by natural selection, not just random drift, when they look at cultural change. Hence the appropriation from biology of the term "mutation rate". There is even a word for what they hope will turn out to be the cultural equivalent of a gene. This word is "meme". People's names and the patterns on clay pots would be good examples of memes, if such things do, in fact, exist.

All may not be lost, though. Non-randomness clearly exists alongside the basic random pattern. The celebrity effect, for example, works not only for names, but for dog breeds. Dalmatians became popular after the release of a film version of Dodie Smith's novel "101 Dalmatians". Celebrity, therefore, seems to

be one way for memes to gain fitness—and, crucially, one that benefits the meme (in the sense of allowing it to spread) without benefiting the individual transmitting it (no one has ever shown that possession of a particular name brings advantages).

However, celebrity is transient and familiarity does breed contempt. Today, Dalmatians—just like the name John—are far less popular than they used to be.

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Nutrition

Big news

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The Atkins diet seems to work, and may bring other health benefits, too

AP

FOR decades, the Atkins diet has been dismissed and disparaged by dieticians, doctors and nutritionists as faddy or dangerous or both. When Dr Atkins himself died in 2003, after slipping on an icy pavement, he had only just started to see the diet he invented considered seriously. This week, though, two papers in the *Annals of Internal Medicine* confirm earlier studies showing that the diet works, and demonstrate that it brings benefits to those with heart diseases or diabetes.

In both studies, a low-carbohydrate diet of the sort Dr Atkins recommended was compared with a low-fat diet over the course of a year. One of the studies was conducted by researchers at the Veterans Affairs Medical Centre in Philadelphia. Researchers at Duke University did the second, which was funded by the Atkins Foundation, an organisation set up by Dr Atkins to promote his ideas. Both studies found what dieters have known for a while: that weight is lost more quickly on Atkins. After six months, both Atkins groups had lost more weight than their low-fat counterparts. However, by the end of the study, each group of dieters had lost about the same amount of weight.

Although the Atkins diet is laden with protein and contains a plentiful supply of fat, dieters showed an increase in the level of their high-density lipoproteins (so-called “good” cholesterol) and no increase in the level of their low-density lipoproteins (“bad” cholesterol). In addition, people with diabetes had better control of their blood-sugar levels when on Atkins.

The reason that the diet has been the target of consistent abuse from the scientific establishment is that its rules contradict the central pillars of received nutritional wisdom. These are that eating a diet which is low in fat and high in starch reduces the risk to the consumer of developing heart disease and cancer, and also promotes weight loss. Food retailers responded to such advice in the 1990s with low-fat “healthy” options in milk, cheese, spreads, sauces and pre-prepared meals. Pasta and bread were to be favoured over meat-and-two-veg. And if meat was ever to appear in a meal, it was to be trimmed of fat. Atkins, however, says people must ditch the muesli and start tucking into bacon and eggs.

The most telling comment on the two new studies comes from Walter Willett, a nutritionist at the Harvard School of Public Health. In an editorial that accompanies the papers, he says “we can no longer dismiss very-low carbohydrate diets”, adding that “Dr Atkins deserves credit for his observations that many persons can control their weight by greatly reducing carbohydrate intake and for his funding of trials by independent investigators.” Nevertheless, some nutritionists are less than welcoming of the new findings, and are warning about the unknown health effects of following Atkins in the long term, and of nutritional deficiencies in the diet.

Although the ultimate outcomes of the low-fat and low-carbohydrate diets in the experiments were the same, in that people lost similar amounts of weight over the course of a whole year, this is unlikely to deter the hordes of Atkins aficionados who swear by the diet. They argue that it is easier to adhere to (proteins do indeed make people feel fuller for longer), and that they suffer from fewer of the hunger

pangs and mood swings that are characteristic of low-fat diets.

Shortly before Dr Atkins died, Larry King interviewed him on his television show. “Do you have a feeling of I told you so?” he asked. Dr Atkins replied, “I've had that feeling all along.”

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About sponsorship

Suicide bombers

Shireen and others like her

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Getty Images

What drives them to their ghastly deeds?

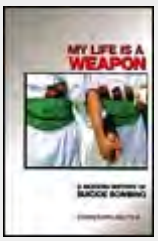
ISRAELI secret-service analysts, writes Christoph Reuter, a reporter for Germany's *Stern* magazine, have spent years working on the profile of the "typical suicide assassin", only to conclude that there is no such person. His well-researched history of suicide attacks, which touches on the 12th-century Assassins but concentrates on today, shows this to be generally true. Suicide attackers can be educated and uneducated; religious and secular; comfortably off and destitute: their link is the decision they make to transform their powerlessness into extraordinary power. No credible threat can be made against those who have no desire to survive.

Nor does Mr Reuter believe that the men and women who kill themselves in order to kill others are puppets manipulated by sinister forces. The groups to which they belong, he argues, do little more than reinforce an existing disposition: for most, there is no call for a Pied Piper. There are exceptions: the Japanese *kamikaze* pilots in the second world war were obeying orders; the 10,000 Iranian children who in the 1980s were thrown across minefields into the line of Iraqi fire, with a little "key to paradise" round their necks, were cruelly recruited or abducted, and then indoctrinated into martyrdom.

In the early 1980s, Hizbullah and the other radical Shia Muslim groups in Lebanon were the first to brand suicide attacks as "martyr operations". Their attacks were designed sparingly, to generate the maximum effect for the minimum number of martyrs: the car bomb that killed 241 American marines drove the Americans out of Beirut. Soon, suicide attacks were embraced by others, including the secular nationalist Tamil Tigers in Sri Lanka.

Far more sinister is the shadowy global network of al-Qaeda ("the base"), an opaque organisation that permeates national frontiers with the aim of hurting America and its allies. Mr Reuter retells the story of Osama bin Laden and the encouragement, rebuffs and fanaticism that led eventually to September 11th 2001. He emphasises the problems of fighting a "war" against a vast clandestine

My Life is a Weapon: A Modern History of Suicide Bombing
By Christoph Reuter



Princeton University Press; 200 pages; $24.95 and £16.95

Buy it at
Amazon.com
Amazon.co.uk

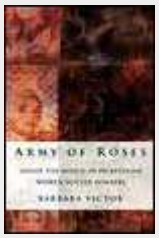
Army of Roses: Inside the World of Palestinian Women Suicide Bombers
By Barbara Victor

decentralised operation, with small cadres based in towns across Asia and Africa, and he describes how the network colonises and infiltrates separatist movements from Iraqi Kurdistan to Karachi and Chechnya.

It has not, or not yet, infiltrated the Palestinian groups which, for many, have become synonymous with suicide bombing. In 1993, when a “human bomb” first rocked Israel, Palestinian society at large disapproved of the method and the random slaughter of Israeli innocents. But as Israel's retaliation grew harsh, the attacks were increasingly endorsed and accepted. The promised short-cut to paradise, Mr Reuter argues, is a consolation for the attack, not the reason—though it is alarming to read of children fantasising about the chocolate cake with coconut flakes that they will get in a martyr's heaven.

Barbara Victor has made a study of the half a dozen or so Palestinian women who have volunteered as suicide bombers, possibly inspired by Yasser Arafat's boasting of his “army of roses” that could crush Israeli tanks. She argues that these women are pushed by something beyond the usual “fatal cocktail” of religious doctrine, nationalist fervour, economic and social deprivation, and the hardships of occupation. They have, she says, been marginalised by Palestinian society, either because they are divorced; have been pregnant out of wedlock; are under pressure to marry somebody they don't want to; or have been badly humiliated by the Israelis at a checkpoint. It is their second-class status as women that is at fault.

This is not altogether convincing, but Ms Victor points out that the family of a female suicide bomber gets only $200 a month compared with $400 for a man. Contradicting Mr Reuter's thesis that the Palestinian bombers act on their own initiative, she believes that several of the women were at the mercy of, or in love with, their handlers.



Rodale Press; 320 pages; $25.95. Constable & Robinson; £8.99

Buy it at
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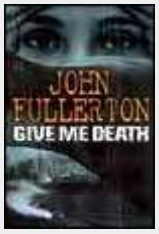
Give Me Death
By John Fullerton



Macmillan; 352 pages; £16.99 (to be published in July)

Buy it at
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Ms Victor has some good interviews, in particular with the Hamas leader Abdel Aziz Rantisi, who has since been assassinated by the Israelis. At first the clerics were against women being recruited, but most of them later changed their minds. She talked at length to a young female prisoner who had helped a suicide bomber and had no regrets, to the families of bombers who strived, not always successfully, to put on a brave front, and also to the shattered families of their Israeli victims.

In his spy thriller about a young Lebanese woman who decides to give her life assassinating a powerful enemy during Lebanon's complex civil war, John Fullerton combines Mr Reuter's driven individual with Ms Victor's exploited one. His attractive fictional heroine, Reem, is certainly under the influence of her sinister “Uncle Faiz”, but she makes the decisions for herself. Dedicated and fully aware, Reem is a long way from the beautiful real-life 15-year-old Shireen, whom Ms Victor interviewed after she had been caught (and let go) by the Israelis before she had had time to be fitted for her explosive belt. When asked why she had wanted to become a *shahida* (female martyr), Shireen replied: “I don't know. It sounded like fun.”

My Life is a Weapon: A Modern History of Suicide Bombing.
By Christoph Reuter.
Princeton University Press; 200 pages; $24.95 and £16.95

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The Qur'an

Found in translation

May 20th 2004
From The Economist print edition

ONE of the original attractions of Islam was its emphasis on equality, that all people are “as equal as the teeth of a comb” in the words of its prophet, Muhammad. Yet when it comes to reading the Qur'an—Islam's holy book—some feel distinctly less equal than others. Arabic-speakers marvel at the glory of the book's language, which Muslims take as proof of their belief that this is no human creation, but rather the direct word of God revealed to Muhammad.

Non-Arabic-speakers on the other hand have had to make do with translations which fail to capture the grandeur of the original. There have been English versions of the Qur'an since 1649, but they generally turn transcendent Arabic into foreign-sounding English. Moreover, unlike the Bible, the Qur'an is not organised chronologically, and its *suras*, or chapters, do not contain the sort of paragraphing and punctuation familiar to English-speaking readers.

Not so this latest translation by Muhammad Abdel Haleem, professor of Islamic studies at the University of London's School of Oriental and African Studies. He has managed to transform the complex grammar and structure of the holy book into a form of modern English which reads easily and flows smoothly without taking liberties with the inviolable text. This turns the Qur'an into a book which allows English-speakers to peer further into the heart of Islam, from its basic precepts on, say, fasting, to its view of the after-life. This is crucial, not just for the growing majority of Muslims who do not speak Arabic as a first language, but for non-Muslims who are curious about this controversial religion. Mr Abdel Haleem argues it is time that English became one of the familiar languages of Islam, like Urdu.

While excellent, the translation inevitably lacks the power of the original. The translator himself points out that there are many aspects of the Qur'an in Arabic which are impossible to communicate easily in another language without changing the meaning of the sacred text. And so, while it may fail to inspire all readers, it should at least inform them. Given the tension between Islam and the West, that is a blessing.

The Qur'an.
A new translation by M.A.S. Abdel Haleem.
Oxford University Press; 464 pages; $27 and £14.99

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The papers of Sir Arthur Conan Doyle

A tangled skein

May 20th 2004
From The Economist print edition

Controversy surrounded this week's sale at Christie's

"I NEVER remember feeling tired by work, though idleness exhausts me completely," said Sherlock Holmes, a sentiment clearly shared by the great detective's creator, Sir Arthur Conan Doyle, on the evidence of the chunk of his private papers that were auctioned at Christie's in London this week. The long unseen collection shows that Conan Doyle was not only one of the most popular writers of the 20th century—he has still outsold J.K. Rowling and J.R.R. Tolkien put together—but a public figure who took an active interest in politics and war, championed many private causes and gave £250,000 (millions in today's money) to further the interests of spiritualism.

Born in 1859, the energetic Scotsman qualified as a surgeon, unsuccessfully stood for Parliament twice and bowled out W.G. Grace, the legendary hirsute cricketer. He frequently sent his opinions to generals and politicians, often with diagrams explaining where their various battles had gone wrong. Notes from Winston Churchill sold this week thank him for supporting the introduction of tanks, invite him to dinner and even concede to his criticism: "No doubt you are right about [the battles of] Mons and Le Cateau and my phrase about Haig was too sweeping."

Letters from contemporary writers assess their own work as well as praising his. Oscar Wilde admits, "I throw probability out of the window for the sake of a phrase", and Rudyard Kipling says he read Conan Doyle's "Rodney Stone" "in one gulp". Particularly charming are the letters from P.G. Wodehouse, who laments that his friend "won't get to see my new mauve smoking-jacket! My wife bought it for me and insists on my wearing it on all occasions, but only in the house."

Befittingly, the auction has not been without controversy, not least thanks to the mysterious death of Richard Lancelyn Green, a former chairman of the Sherlock Holmes Society of London, who was found garrotted in his locked bedroom in March. There was not enough evidence for the coroner to rule it was suicide, but enough for believers in the "Conan Doyle curse" to suspect foul play worthy of Holmes's attention. Lancelyn Green believed that some of the papers in the auction had rightfully been left to the British Library, and he told the *Times* newspaper that he had written to Christie's asking them not to go ahead with the sale, which Christie's denies.

Would-be Conan Doyle biographers, as well as the British Library, have expressed disappointment that the material in the auction has now been dispersed. However, the lots have been on public display at Christie's for some time as well as being detailed on its website. Moreover, the auctioneers estimate that they account for only a quarter to a third of Conan Doyle's papers. A star item at the sale—a set of notebooks, including a sketch for the very first Holmes story, "A Study in Scarlet" (originally titled "A Tangled Skein")—fetched £120,000 ($214,000). The plaque outside the author's Portsmouth surgery was sold for £18,000.

The vast majority of Holmes-related manuscripts are already in private collections around the world. Institutions hold around 60%, and these are available to those who want to study them. Lancelyn Green's planned three-volume biography of Conan Doyle will never come to light, but now that most of his papers are in the open, others can take up the task.

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Shipping

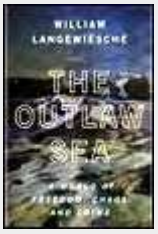
Cowboys who ride the high seas

May 20th 2004
From The Economist print edition

THERE are 40,000 ships plying the oceans, most of them crewed by the world's poor, owned by shadowy offshore companies and flying flags of convenience. In this terrifying account of their cowboy practices, William Langewiesche says that these ships carry “almost all the raw materials and finished products on which our land lives are built.” They embody global capital and trade, and they represent free enterprise at its freest. Yet they extract a huge price: polluting shipwrecks; fatal accidents; piracy; and the deadly threat of maritime terrorism.

In understated prose that highlights the dangers inherent in the freedom of the seas, Mr Langewiesche points out the helplessness of American officials who believe that a large-scale maritime terrorist attack currently poses the most serious threat to their national security. He explains how the US Coast Guard's 50,000 employees are no match for the 60,000 calls made at American ports each year by ocean-going ships, many of which have crews from troubled parts of the world who necessarily bypass standard immigration procedures. These vessels are stacked high with containers whose contents it is impossible to scan or inspect.

The Outlaw Sea: A World of Freedom, Chaos, and Crime
By William Langewiesche



North Point Press; 239 pages; $23

Buy it at
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On the high seas the vessels face industrial-scale piracy. Gangs of organised, armed and ruthless pirates, operating mostly in the South China Sea (including the waters of Indonesia and the Philippines), earn a living by hijacking entire ships, killing or marooning their crews, and changing the vessels' identity in mid-ocean by renaming and repainting them while under-way. The “phantom” ship then enters a port as a legitimate vessel and sells its stolen cargo before picking up new freight and disappearing again.

A large part of “The Outlaw Sea” focuses on the reasons for, and the impact of, maritime accidents: the “several thousand” sailors who died during the 1990s alone; the wrecking of the oil tankers *Exxon Valdez* and *Amoco Cadiz*, and the environmental destruction that followed; the sinking of the ferry *Estonia* in the Baltic with the loss of over 850 lives; and, in December 1987, the modern world's worst accident at sea, a fire on an overcrowded Filipino ferry that killed 4,375 people, including 1,000 children. The book concludes in Alang, India, where 183 filthy and dangerous ship-breaking yards employ thousands of impoverished workers to dismantle around half of the 700 ships that reach the end of their life each year.

Mr Langewiesche is especially good on how the ocean, which “looks tight in print”, can descend into such chaos in practice. He explains clearly the system of flags of convenience which makes tiny Panama and land-locked Bolivia significant maritime nations, and he shows up the difficulty in trying to govern the ocean and its users through numerous unenforceable regulations generated by the United Nations' International Maritime Organisation, a “typically idealistic construct” based in London.

Despite such well-intentioned regulations and the wish of the world to make the ocean a safer place, the anarchic chaos remains. The outlaw sea—spanning three-quarters of the surface of the globe—remains the last true wilderness on earth.

The Outlaw Sea: A World of Freedom, Chaos, and Crime.
By William Langewiesche.
North Point Press; 239 pages; $23

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New fiction

Death in Amsterdam

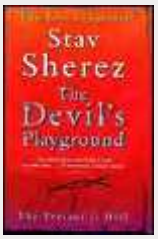
May 20th 2004
From The Economist print edition

JON REED is crass, unsociable and incapable of delivering his work on time. His mind should be numb enough not to need narcotics, but he's always agitated in the morning. Smoking cigarettes is one thing that calms him; smoking and playing Frank Zappa on the stereo.

In an uncharacteristic gesture—one that even he does not fully understand—Jon offers a room in his London flat to a tramp that he meets outside the dole office. A week later, the tramp's body is discovered, mutilated and face down in an Amsterdam park. A serial killer has already murdered eight girls in similar circumstances over the past year; this is the first time the victim has been a man. Jon's phone number is on a slip of paper that is hidden in a paperback inside the tramp's coat.

A call from the detective investigating the case starts to lift Jon out of his torpor. Along the way, he learns about body piercing, sado-masochistic sex, the white-slave trade and Josef Mengele's journey into experimental eugenics. He also, for the first time, allows himself to wonder about his dead father, who would never admit to being Jewish.

The Devil's Playground
By Stav Sherez



Michael Joseph; 448 pages; £12.99

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Choosing Amsterdam as a setting is a smart move. Not only do the canals and fog impart an eerie atmosphere, but the city's liberal sex-and-drug laws offer the author an opportunity to explore the nature of freedom. The theme of exposing Nazis gives the book a whiff of “The Boys from Brazil”. In less talented hands this might have been a mistake. Far from feeling dated, though, the story has a thoroughly contemporary texture.

Stav Sherez is a gifted writer, as good at evoking the heart of a piece of music or the dank smell of a city as he is at juggling several thought-provoking themes at once. “The Devil's Playground”, his first book, deserves to be the thriller of the summer.

The Devil's Playground.
By Stav Sherez.
Michael Joseph; 448 pages; £12.99

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Mayan civilisation

Blood-curdling aesthetes

May 20th 2004 | WASHINGTON, DC
From The Economist print edition

A reassessment of the arts and minds of a great pre-Columbian culture

AN EXHIBITION at the Kimbell Art Museum in Fort Worth, Texas, in 1986 marked a revolution in understanding the Mayan civilisation. Now one of the organisers of that show, Mary Ellen Miller, a professor at Yale, has co-produced a second exhibition, “Courtly Art of the Ancient Maya”, at the National Gallery of Art in Washington, DC. The show, says David Stuart, a Mayan scholar, is “the most beautiful exhibition of classic Mayan art I have ever seen.” Like the earlier exhibition, it reflects a changing view about the people who, from the second to the tenth centuries AD, created the most highly developed civilisation of pre-Columbian America.

For much of the 20th century, students of the Mayan people considered them to be peaceful horticulturalists, governed by priests and ritual, without kings, cities, politics, violence or war. The title of the Kimbell show, “The Blood of Kings”, was a rebuttal of that view. Here were gore-spattered battles and scenes of putrefaction and disease. One carved panel showed a kneeling woman drawing the ancient equivalent of barbed wire through her tongue. So much for the Maya as pacifist stargazers.

The current exhibition is not quite so radical an act of reinterpretation. The scenes of war and bloodlust are still there. The high point of the exhibition is a recreation—more vivid than the eroded original found in the Mexican jungle—of a mural showing captives being paraded after a battle before the victorious king and having their fingernails ripped out. The discovery of such murals was partly responsible for knocking the stuffing out of the pacifist theory in the first place.

But researchers are now moving from establishing facts about the Maya towards understanding the meaning of their rituals. The decipherment of their script has been the greatest achievement of recent years. The Maya invented what may be the most complex writing system ever devised. It had both alphabetic and pictographic characters, and the “spelling” rules seem to have been largely aesthetic. The same word could be written in a dozen ways. The new exhibition contains superb examples of the most florid, which look more like sculpture than writing.

At the time of the Kimbell show, translations were often imprecise. Now scholars can read almost all classic Mayan texts. In 1986 the most important artefacts were carved royal portraits, recording martial activities at site after site. Now, the great men are set squarely in the context of their courts. The first things in the exhibition are statues of scribes. Scholars have deciphered signatures of individual artists who appear to have been, in the Mayan world, aristocrats in their own right, not hired purveyors in the western tradition.

The emphasis has shifted from the king to the people who ensured that his court had the right food, music and painting. Simon Martin, a specialist in ancient scripts, says these discoveries take the Maya out of the “creepy-brutal” category and put aesthetics centre-stage. In 1986 there was no sense that the Mayan world had any broad political organisation. It had atomised city states whose history seemed to consist of a stream of battles. But Mr Martin has worked out an almost day-by-day account of events in the plain of Tabasco for the year 662—an extraordinary testament to the society's meticulous record-keeping. The picture that emerges is one of shifting allegiances and diplomatic machinations in which one city state, Palenque, was manoeuvred out of an area of rich farmland by two other states.

Mayan religion, by contrast, still seems a little confusing. The attributes and sometimes the names of a multitude of gods are known, but how they relate to each other is not. The exhibition suggests, however, that this too is becoming clearer—through a new account of two deities.

Then, as now, maize was the staff of life in Central America. The Maya thought of human beings as in

some way made of maize: they distorted babies' soft skulls to make them look like a head of corn. They probably practised cannibalism: for them, it was like eating maize. And in Mayan cosmology there was a maize god who was beheaded every year (like the crop) and reborn in the underworld. But not as maize; rather as a magic tree from which all fruit sprang.

A second deity (known as God L) then harvested the fruit, especially cocoa, and became rich. Eventually, the maize god's twin sons kill God L and take maize back to earth. Hence the Maya creation myth sets up a dichotomy between the god of maize (and youth, and farming, and light) and a wizened God L (of the underworld, cocoa, tobacco and disease). When Spanish explorers reached the Yucatan, they reported that “the defeat of Lucifer is already known here”. Even now, Easter celebrations in highland Guatemala include a mythic figure called Maximon, who is a sort of descendant of God L.

In 2001, in one of the most dramatic finds in 50 years of Mayan archaeology, a magnificent mural was unearthed at the ruins of San Bartolo, in Guatemala. It depicts a creation myth—the Sistine Chapel of the Maya—and is still being interpreted. As with the exhibition of 1986, this new show could coincide with a significant breakthrough in our understanding of this remarkable civilisation.

“Courtly Art of the Ancient Maya” is at the National Gallery of Art, Washington, DC, until July 25th, and then at the Palace of the Legion of Honour, San Francisco, from September 4th to January 2nd 2005.

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About sponsorship

Clement “Sir Coxsone” Dodd

May 20th 2004
From The Economist print edition

Clement “Sir Coxsone” Dodd, father of reggae, died on May 4th, aged 72

WHEN the post-war Jamaican immigrants stepped off the ship in London—the women in A-line dresses, the men in neat hats—Jamaican music was a sleepy and harmless thing. Tallymen tallied bananas, and yellow birds sang in the trees. Few would have believed that in half a century the island's sound, played round the world, would be so heavily percussive and explicit that it would form a natural background for Yardie fights for drug turf in Brooklyn or Brixton.

Clement Dodd (the “Sir” was adopted, and the “Coxsone” was borrowed from a Yorkshire cricketer whose style he admired; he was always “Sir Coxsone” on the streets of Jamaica) never liked what the music had become. Reggae was meant to express peace, love and human solidarity. He lost patience with it once computers were brought in and obscenity cluttered the lyric line. Yet much of it was his music all the same, based on rhythms he and his players had invented in his tiny studio in Kingston. In the time-honoured tradition of the Jamaican recording industry, brash young musicians kept copying his “riddims”, sampling and recycling them, to lay under new songs. In his later years, Mr Dodd employed lawyers to watch for copyright infringement. They may as well have policed an ants' nest.

The world in which he worked was chaotically creative. As Jamaican music blossomed through the 1960s and 1970s, progressing from “ska” to “rocksteady” to reggae itself, several record-producers and artists claimed credit for it. But the beginning of the whole thing, when a little more drum and kick were added to *mento*, the native folk-music, to make ska, was usually credited to Mr Dodd's experimenting. He hummed the new rhythm, his band-leader followed, and an industry was born that fuels reggae and hip-hop down to the present day.

It was also Mr Dodd who discovered, in Bob Marley and the Wailers, an international voice for reggae music. He had just opened his studio at 13 Brentford Road, in 1963, when Marley came to see him. He looked scruffy; Mr Dodd put him and his band in sharkskin suits, made Marley the lead vocalist, and offered them a five-year contract. Marley looked on Mr Dodd as a father; Mr Dodd tolerated his Rastafarian ways, letting him smoke a little ganja under the almond tree in the yard. As Marley's music became more militant and drug-fuelled, the two men drifted apart; but the great reggae and Rasta anthem, “One Love”, was nonetheless a Studio One production.

The opening of Studio One was in itself a triumph. Mr Dodd was the first black to own a studio in Jamaica, and the first to own a record-pressing plant. Musically, the island in the 1950s was a segregated place. All the radio stations were owned by middle-class whites, as were the record companies. Blacks, by contrast, controlled the dance venues, many of them open to the air. Music had to be very loud

indeed to compete with night insects, frogs, the sea and the muffling cloak of humidity.

On the radio, old-fashioned crooners prevailed. Good jazz and bebop, from American broadcasts, could not be picked up in much of the island. As a teenager, Mr Dodd did his bit for musical improvement by playing Lionel Hampton out of the window of his mother's liquor store on Laws Street in Kingston, regaling her customers as they drank their beer. A few years later, he dragged his own sound system—a turntable, huge speakers, a box of records—out to dusty parks and seaside promenades.

His records, mostly R&B, were his particular pride. He had picked them up in the United States, spending the money he had earned as a cane-cutter in Florida to take the train to New York and rifle through the stock of Rainbow Records in Harlem. Once home, competing with other DJs at the open-air dances, it was vital not only to have the biggest, loudest sound system but also the newest sounds. Rivalry was so intense that the names of songs and artists would be scratched off the records, in case other DJs tried to find them.

Eventually, however, Jamaica outgrew imported rock 'n' roll. Mr Dodd began to record local sounds and singers, and by 1959 was producing records on his own label. His greatest rival, Arthur “Duke” Reid, began with a competing sound system and progressed to a competing label and studio, while artists were poached back and forth between them.

Though violence was a relative latecomer to the lyrics and the music, it was never far away. In the 1960s, hooligans would smash up dance halls. In 1979, Studio One was attacked by armed bandits, probably in search of precious vinyls rather than equipment. Mr Dodd went off to Brooklyn, where he opened a music store on Fulton Street. Only in 1998 did he come back to Brentford Road.

By then, he was a national celebrity. Four days before his death, Brentford Road was renamed “Studio One Boulevard” in his honour. An elderly percussionist who played that day brought ripe bananas and water coconuts from the country for him, while the island's newspapers wished him “maximum respect”. Government ministers applauded him for proving that Jamaica had its own proud voice in the world. He himself continued to worry, just a bit, about the increasingly angry forms that voice was taking.

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Overview

May 20th 2004
From The Economist print edition

Inflation is slowly gaining ground in **America**. Although the broad-based CPI measure rose by only 0.2% in April, core inflation, which excludes the more volatile prices of food and energy, ran at 1.8% in the year to April. That is a hefty rise from 1.1% core inflation in the year to December. Producer prices rose at a healthy clip of 0.7% in April. The inflation figures were taken as another sign that an interest rate rise is likely as early as June.

America's **housing market** cooled slightly. Housing starts fell by 2.1% in April, but the number of starts remained high by historical standards. Higher interest rates have yet to cause an expected weakening of the housing market.

Industrial output in the **euro area** fell by 0.2% in March. In the year to March, it was up by a meagre 1.0%.

Several individual euro-area economies seem to be perking up. **Germany's** economy grew in the first quarter by 0.4%. In the year to the first quarter, GDP expanded by 1.5%. **France's** economy grew by 0.8% in the first quarter, its fastest pace since 2000. For the first time in a while, both investment and consumer spending are growing strongly. **Italy's** economy grew by 0.4% in the first quarter, and by 0.8% in the year to that period. But Italy's industrial output, which has been weak in recent months, suffered a surprise fall of 0.4% in March. In the year to March, industrial output in Italy was down by 0.6%. The **Dutch** economy matched Italy's figures exactly, posting GDP growth of 0.4% in the first quarter, and 0.8% in the year to that period.

Japan's economy grew in the first quarter by 0.8% in nominal terms, which was the fastest pace since 1996 and above expectations. In real terms, allowing for Japan's price deflation, growth in the first quarter hit an annualised pace of 5.6%. Industrial production rose by 8.3% in the year to March.

Retail sales in **Switzerland** rose by 5.4% in the year to March.

Britain's consumer price index (CPI) rose by 0.4% in April. Inflation in the year to April ran at 1.2%, slightly above the 1.1% pace at which it grew in the year to March.

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Output, demand and jobs

May 20th 2004
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2004	2005	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 4.0	Q4	+ 5.5	+ 3.9	+ 3.1	– 0.9	Q4	+ 7.7	Q1	5.6	Apr	6.2
Austria	+ 0.8	Q4	+ 0.4	+ 1.6	+ 2.0	+ 2.5	Feb	– 1.0	Feb	4.5	Apr	4.3
Belgium	+ 1.9	Q1	+ 2.4	+ 1.9	+ 1.9	+ 5.4	Mar	– 0.9	Feb	12.4	Apr†	11.6
Britain	+ 3.0	Q1	+ 2.6	+ 3.2	+ 2.7	– 0.6	Mar	+ 6.4	Mar	4.7	Feb††	5.1
Canada	+ 1.6	Q4	+ 3.8	+ 2.7	+ 3.3	+ 0.8	Feb	+ 2.5	Feb	7.3	Apr	7.6
Denmark	+ 1.0	Q4	+ 2.4	+ 1.9	+ 2.2	– 1.0	Feb	+ 5.3	Feb	6.4	Mar	5.8
France	+ 1.7	Q1	+ 3.1	+ 1.8	+ 2.1	+ 1.5	Mar	+ 2.9	Mar	9.8	Mar	9.6
Germany	+ 1.5	Q1	+ 1.8	+ 1.4	+ 1.6	– 0.7	Mar	– 0.7	Mar	10.5	Apr§	10.7
Italy	+ 0.8	Q1	+ 1.7	+ 1.0	+ 1.7	– 0.6	Mar	– 2.1	Feb	8.5	Jan	8.9
Japan	+ 4.7	Q1	+ 5.6	+ 3.3	+ 2.0	+ 8.3	Mar	– 2.2	Mar	4.7	Mar	5.4
Netherlands	+ 0.5	Q1	+ 1.7	+ 0.8	+ 1.6	– 1.0	Mar	– 4.6	Feb‡	6.4	Apr**	4.9
Spain	+ 2.8	Q1	+ 2.4	+ 2.8	+ 2.9	+ 8.0	Mar	+ 4.5	Mar	11.1	Mar	11.4
Sweden	+ 1.9	Q4	+ 2.2	+ 2.4	+ 2.4	+ 2.2	Mar	+ 5.3	Mar	5.8	Mar†	4.6
Switzerland	nil	Q4	+ 1.8	+ 1.6	+ 1.8	+ 1.7	Q4	+ 5.4	Mar	3.9	Apr†	3.6
United States	+ 4.9	Q1	+ 4.2	+ 4.7	+ 3.6	+ 3.4	Mar	+ 9.2	Mar	5.6	Apr	6.0
Euro area	+ 0.6	Q4	+ 1.2	+ 1.6	+ 2.0	+ 1.0	Mar	+ 0.9	Mar	8.8	Mar	8.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 1.6	Q4	+ 1.1	na	na	nil	Mar	+ 3.6	Feb	9.5	Mar†	9.9
Greece	+ 5.0	Q4	na	na	na	+ 3.8	Mar	+ 6.4	Feb	na		na
Iceland	+ 4.9	Q4	na	na	na	– 0.3	2002	na		3.5	Mar†	4.0
Ireland	+ 2.7	Q4	na	na	na	+ 5.9	Mar	+ 2.6	Feb	4.4	Apr	4.4
Luxembourg	+ 1.3	2002	na	na	na	– 1.2	Dec	+ 3.9	Dec	4.3	Mar	3.7
New Zealand	+ 3.2	Q4	+ 2.4	na	na	+ 3.2	Q4	+ 8.0	Q1	4.3	Q1	4.9
Norway	+ 0.5	Q4	+ 2.4	na	na	+ 5.9	Mar	+ 7.6	Mar	4.5	Q1	4.4
Portugal	– 0.5	Q4	– 1.0	na	na	– 4.5	Feb	+ 2.7	Mar	6.4	Q1†	6.4

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Dec-Feb; claimant count rate 2.9% in Apr. §EU harmonised rate 9.3 in Mar. **Feb-Apr.

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Prices and wages

May 20th 2004
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2004	2005	latest		year ago	latest		year ago
Australia	+ 2.0	Q1	+ 3.4	+ 2.2	+ 2.5	– 1.1	Q1	+ 3.0	+ 5.9	Q4	+ 3.9
Austria	+ 1.6	May	+ 1.1	+ 1.3	+ 1.4	+ 5.2	Apr	+ 0.8	+ 2.1	Mar	+ 2.2
Belgium	+ 1.9	Apr	+ 1.5	+ 1.4	+ 1.5	+ 2.2	Mar	+ 0.8	+ 1.9	Q1	+ 2.4
Britain	+ 1.2	Apr*	+ 1.5	+ 1.5	+ 1.8	+ 1.8	Apr	+ 1.6	+ 5.2	Mar†	+ 3.3
Canada	+ 0.7	Mar	+ 4.3	+ 1.6	+ 2.0	– 1.4	Mar	+ 1.7	+ 3.1	Feb	+ 2.2
Denmark	+ 0.8	Apr	+ 2.5	+ 1.4	+ 2.0	+ 1.6	Apr	– 0.5	+ 3.7	Q4	+ 3.9
France	+ 2.1	Apr	+ 2.0	+ 1.9	+ 1.6	+ 0.1	Mar	+ 2.1	+ 2.7	Q4	+ 3.5
Germany	+ 1.6	Apr	+ 1.0	+ 1.2	+ 1.1	+ 2.4	Apr	– 3.8	+ 1.4	Mar	+ 3.6
Italy	+ 2.3	Apr	+ 2.7	+ 2.2	+ 2.1	+ 0.6	Mar	+ 2.8	+ 2.8	Mar	+ 1.7
Japan	– 0.1	Mar	– 0.1	– 0.2	nil	+ 0.5	Apr	– 0.8	+ 1.8	Mar	+ 2.7
Netherlands	+ 1.4	Apr	+ 2.1	+ 1.3	+ 1.3	+ 0.6	Dec	+ 4.2	+ 1.8	Mar	+ 3.2
Spain	+ 2.1	Mar	+ 3.7	+ 2.3	+ 2.4	+ 0.8	Mar	+ 3.0	+ 3.3	Q4	+ 3.9
Sweden	+ 0.3	Apr	+ 2.3	+ 0.8	+ 1.6	– 1.4	Mar	+ 0.6	+ 2.9	Feb	+ 2.2
Switzerland	+ 0.5	Apr	+ 0.7	+ 0.4	+ 0.8	– 0.1	Mar	+ 0.3	+ 1.8	2002	+ 2.5
United States	+ 2.3	Apr	+ 2.2	+ 1.9	+ 1.8	+ 3.7	Apr	+ 2.4	+ 2.2	Apr	+ 3.0
Euro area	+ 2.0	Apr	+ 2.1	+ 1.7	+ 1.6	+ 0.4	Mar	+ 2.4	+ 2.5	Q4	+ 3.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	– 0.4	Apr	+ 1.1	na	na	+ 0.3	Apr	– 0.3	+ 3.7	Q4	+ 4.1
Greece	+ 2.9	Apr	+ 3.4	na	na	+ 1.9	Mar	+ 2.0	na		na
Iceland	+ 2.2	Apr	+ 2.3	na	na	+ 2.7	Apr	+ 3.2	+ 3.3	Feb	+ 5.6
Ireland	+ 1.4	Apr	+ 4.3	na	na	– 5.1	Mar	– 7.1	+ 6.1	Q4	+ 6.4
Luxembourg	+ 2.1	Apr	+ 2.2	na	na	+ 0.1	Dec	+ 1.3	– 0.4	Dec	+ 0.7
New Zealand	+ 1.5	Q1	+ 2.5	na	na	– 0.1	Q4	– 1.4	+ 2.2	Q1	+ 2.3
Norway	+ 0.4	Apr	+ 2.9	na	na	+12.2	Apr	– 4.9	+ 3.9	Q4	+ 5.2
Portugal	+ 2.3	Apr	+ 3.7	na	na	+ 0.3	Mar	+ 2.1	+ 2.6	Mar	– 2.6

*New series. RPI inflation rate in April: 2.5%. †Jan-Mar.

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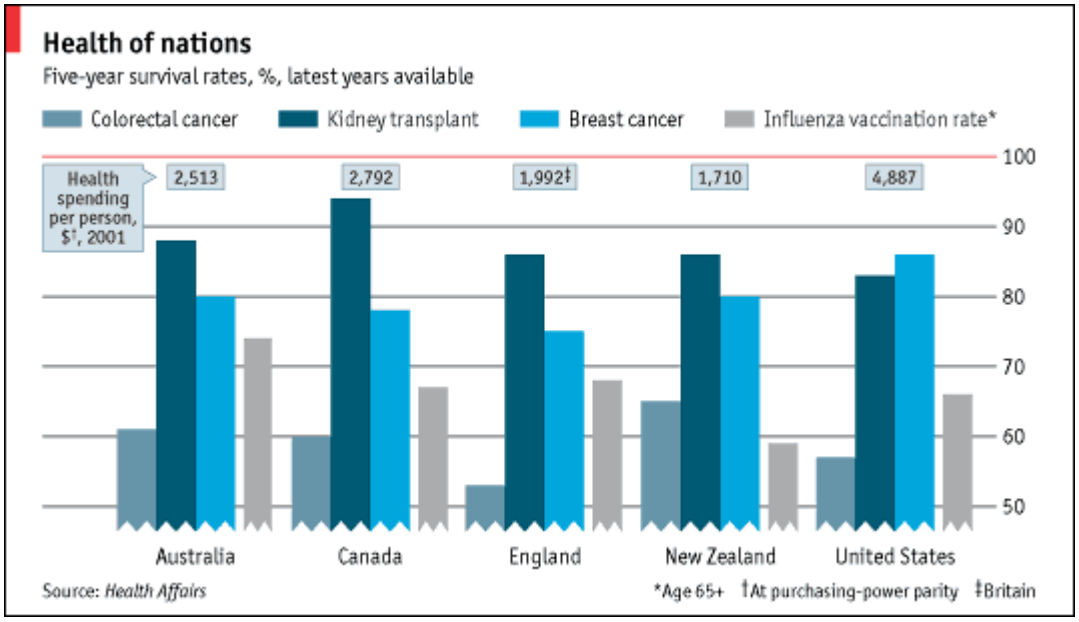
Health of nations

May 20th 2004
From The Economist print edition



Greater health-care spending does not necessarily lead to better outcomes, according to a new comparison of five industrialised countries published in *Health Affairs*, a journal. America spends more on medicine than Australia, Canada and New Zealand, yet it has worse survival rates for colorectal cancer and kidney transplants. All the countries in the chart could prevent flu-related deaths by vaccinating more old people.

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Money and interest rates

May 20th 2004
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (May 19th 2004)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 8.0	+13.9	Mar	5.49	4.71	5.28	6.04	4.90	6.88
Britain	+ 7.1	+ 7.7	Mar	4.50	3.56	4.82	5.14	4.03	5.92
Canada	+11.6	+ 8.9	Mar	2.02	3.20	3.11	5.14	4.62	6.32
Denmark	+ 8.1	+10.6	Mar	2.25	2.60	2.64	4.48	3.91	5.65
Japan	+ 4.1	+ 1.9	Apr	0.02	0.02	0.13	1.50	0.58	1.58
Sweden	+ 0.5	+ 2.2	Mar	1.95	3.16	2.97	4.69	4.16	3.13
Switzerland	+ 9.9	+ 4.1	Apr	0.26	0.28	1.22	2.72	2.16	2.56
United States	+ 6.8	+ 4.9	Apr	1.09	1.20	2.58	4.78	3.38	6.16
Euro area†	+11.4	+ 6.3	Mar	2.09	2.37	2.55	4.28	3.68	4.14

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.48%, Japan No. 259 1.49%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.25%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

May 20th 2004
From The Economist print edition

1995=100

	May 11th	May 18th*	% change on one month	% change on one year
Dollar index				
All items	97.4	94.6	– 4.8	+21.9
Food	97.7	94.0	– 2.7	+17.1
Industrials				
All	97.1	95.5	– 7.6	+28.9
Nfa†	98.7	96.5	– 0.5	+26.7
Metals	95.8	94.7	–12.9	+30.8
Sterling index				
All items	87.5	84.3	– 3.6	+12.6
Euro index				
All items	108.4	104.1	– 5.2	+18.8
Yen index				
All items	117.9	115.1	+ 0.5	+19.3
Gold				
$ per oz	376.75	377.25	– 5.2	+ 2.6
West Texas Intermediate				
$ per barrel	40.07	40.38	+ 8.5	+38.8

* Provisional. † Non-food agriculturals.

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Stockmarkets

May 20th 2004
From The Economist print edition

Market indices

	May 19th	2004 high	2004 low	% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
Australia (All Ordinaries)	3,389.8	3,462.9	3,274.9	+ 0.2	– 2.1	+ 2.5	– 4.8
Austria (ATX)	1,833.2	1,985.9	1,568.9	– 0.8	– 7.7	+18.6	+13.2
Belgium (Bel 20)	2,413.2	2,517.3	2,244.2	+ 2.2	–34.5	+ 7.5	+ 2.6
Britain (FTSE 100)	4,471.8	4,575.7	4,309.4	+ 1.3	–35.5	– 0.1	– 0.5
Canada (Toronto Composite)	8,196.8	8,898.8	8,123.5	+ 0.1	–28.0	– 0.3	– 6.3
Denmark (KBX)	225.6	241.3	219.0	+ 1.2	–25.2	+ 5.6	+ 0.8
France (SBF 250)	2,476.5	2,594.4	2,411.5	+ 1.9	–43.6	+ 2.7	– 2.0
(CAC 40)	3,643.3	3,811.4	3,465.3	+ 2.2	–47.4	+ 2.4	– 2.3
Germany (DAX)	3,872.3	4,151.8	3,726.1	+ 2.5	–52.0	– 2.3	– 6.8
Italy (BCI)	1,290.2	1,340.3	1,239.5	+ 0.4	–40.9	+ 2.7	– 2.0
Japan (Nikkei 225)	10,967.7	12,163.9	10,365.4	– 1.7	–71.8	+ 2.7	– 2.3
(Topix)	1,106.2	1,217.9	1,022.6	– 1.4	–61.7	+ 6.0	+ 0.8
Netherlands (AEX)	332.7	364.8	323.0	+ 2.1	–52.6	– 1.5	– 6.0
Spain (Madrid SE)	830.5	881.7	808.0	+ 0.9	–27.5	+ 2.8	– 1.9
Sweden (Affarsvarlden Gen)	198.7	218.1	188.5	+ 2.5	–50.4	+ 5.5	+ 0.4
Switzerland (Swiss Market)	5,710.0	5,934.4	5,469.0	+ 1.2	–32.1	+ 4.0	+ 0.8
United States (DJIA)	9,937.7	10,737.7	9,906.9	– 1.1	–15.2	– 4.9	– 4.9
(S&P 500)	1,088.7	1,157.8	1,084.1	– 0.8	–28.7	– 2.1	– 2.1
(NASDAQ Comp)	1,898.2	2,153.8	1,876.6	– 1.4	–62.4	– 5.3	– 5.3
Europe (FTSE Eurotop 300)*	982.5	1,026.2	957.9	+ 1.4	–42.4	+ 2.6	– 2.1
Euro area (FTSE Ebloc 100)*	828.1	888.3	806.7	+ 1.8	–46.6	– 0.4	– 5.0
World (MSCI)†	1,014.1	1,085.8	997.0	+ 0.2	–30.0	– 2.1	– 2.1
World bond market (Citigroup)‡	583.2	619.5	575.1	+ 0.8	– 5.9	– 3.4	– 3.4

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

May 20th 2004
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2004	2005	Exchange rate trade-weighted† 1990=100 May 19th	year ago	Currency units per $ May 19th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2004‡
Australia	− 17.0	Mar	− 30.0	Q4	− 5.2	− 4.5	84.4	81.6	1.43	1.52	2.55	1.72	1.27	0.5
Austria	− 0.7	Feb	− 1.9	Feb	− 0.3	− 0.6	103.1§	102.0	0.83	0.85	1.48	–	0.74	-1.3
Belgium	+ 22.1	Mar	+ 8.0	Dec	+ 3.7	+ 3.8	103.2§	102.0	0.83	0.85	1.48	–	0.74	-0.2
Britain	− 83.3	Mar	− 30.8	Q4	− 2.5	− 2.5	104.2	98.3	0.56	0.61	–	0.68	0.50	-2.9
Canada	+ 45.2	Mar	+ 18.5	Q4	+ 1.7	+ 1.1	84.2	86.3	1.38	1.35	2.45	1.66	1.22	1.2
Denmark	+ 9.8	Mar	+ 6.4	Mar	+ 2.5	+ 2.4	106.3	106.7	6.18	6.35	11.0	7.44	5.49	0.9
France	+ 4.9	Mar	+ 10.0	Mar	+ 1.0	+ 0.9	106.8§	105.2	0.83	0.85	1.48	–	0.74	-3.8
Germany	+166.7	Mar	+ 63.3	Mar	+ 2.4	+ 2.4	104.5§	102.5	0.83	0.85	1.48	–	0.74	-3.7
Italy	+ 2.0	Mar	− 19.0	Feb	− 0.9	− 1.0	76.2§	75.0	0.83	0.85	1.48	–	0.74	-3.1
Japan	+118.0	Mar	+153.2	Mar	+ 3.2	+ 3.2	131.7	128.4	113	117	201	136	–	-7.1
Netherlands	+ 32.4	Mar	+ 18.7	Q1	+ 2.3	+ 2.5	102.7§	101.4	0.83	0.85	1.48	–	0.74	-3.1
Spain	− 54.8	Feb	− 25.3	Feb	− 2.9	− 2.9	77.2§	76.4	0.83	0.85	1.48	–	0.74	0.3
Sweden	+ 20.7	Mar	+ 18.9	Q4	+ 5.6	+ 5.4	81.5	80.9	7.56	7.83	13.5	9.10	6.71	0.2
Switzerland	+ 7.9	Apr	+ 32.9	Q4	+10.3	+10.1	112.9	115.0	1.28	1.29	2.27	1.54	1.13	-1.6
United States	−560.4	Mar	−540.9	Q4	− 5.1	− 5.0	99.2	101.7	–	–	1.78	1.20	0.89	-4.7
Euro area	+ 98.2	Mar	+ 37.2	Feb	+ 0.5	+ 0.4	90.4	91.0	0.83	0.85	1.48	–	0.74	-2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 15.0	Mar	+ 10.9	Mar	na	na	82.3§	81.0	0.82	0.85	1.46	–	0.73	1.6
Greece	− 26.3	Feb	− 11.2	Feb	na	na	59.7§	59.0	0.82	0.85	1.46	–	0.73	-3.2
Iceland	− 0.3	Mar	− 0.6	Q4	na	na	98.6**	97.7	73.3	72.9	131	88.2	65.0	0.2
Ireland	+ 41.0	Feb	− 3.0	Q4	na	na	94.4§	93.0	0.82	0.85	1.46	–	0.73	-0.5
Luxembourg	− 3.6	Feb	+ 2.5	Q4	na	na	103.2§	102.0	0.82	0.85	1.46	–	0.73	-1.8
New Zealand	− 2.3	Mar	− 3.5	Q4	na	na	98.8	98.1	1.64	1.71	2.92	1.97	1.46	2.9
Norway	+ 28.2	Apr	+ 29.7	Feb	na	na	97.1	102.9	6.88	6.71	12.3	8.28	6.11	10.4
Portugal	− 14.2	Feb	− 8.1	Feb	na	na	94.0**	92.5	0.82	0.85	1.46	–	0.73	-3.8

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, March average. ‡OECD forecast. **IMF, February average.

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Current-account balance

May 20th 2004
From The Economist print edition

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Overview

May 20th 2004
From The Economist print edition

Political turmoil took its toll on **India's** financial markets. The stockmarket fell by 6.8% in the week to May 19th. In dollar terms, India's stockmarket has fallen by 13.5% since the beginning of the year.

Hong Kong's stockmarket rose by nearly 4% on May 19th, its biggest one-day rise in more than a year. However, share prices are still down by nearly 10% since the start of 2004.

Argentina's energy woes are slowing industrial activity. Industrial output fell by 3.9% during April, although it rose by 9.4% over the previous 12 months. In the year to March, industrial output rose by 12.4%.

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Food supply

May 20th 2004
From The Economist print edition

In a new report, the Food and Agriculture Organisation estimates that 842m people are undernourished. Three-fifths of them live in the Asia-Pacific region, and one-quarter are in sub-Saharan Africa. The food supply in Congo fell by almost 3% a year from 1990 to 2001, to 1,566 kilocalories per person per day. America's food supply rose over the same period to 3,769 kilocalories per person per day. The FAO argues that agricultural biotechnology could do much to alleviate hunger in poor countries, given more targeted investment and better regulation.

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Economy

May 20th 2004
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.8	Q1	+19.1	Apr	+ 3.0	Mar	+14.7	Apr	+45.9	2003	439.8	Mar
Hong Kong	+ 5.0	Q4	– 6.1	Q4	– 2.1	Mar	–10.3	Mar	+17.4	Q4	122.1	Apr
India	+10.4	Q4	+ 6.7	Mar	+ 3.5	Mar	–15.4	Mar	+ 3.2	Q4	113.0	Apr
Indonesia	+ 4.4	Q4	+ 5.1	Jan	+ 5.9	Apr	+28.3	Mar	+ 7.8	Q3	36.1	Mar
Malaysia	+ 6.4	Q4	+13.2	Mar	+ 1.0	Apr	+20.6	Mar	+12.3	Q4	50.4	Mar
Philippines	+ 4.5	Q4	nil	Feb	+ 4.1	Apr	– 1.7	Mar	+ 3.3	Dec	13.4	Apr
Singapore	+ 7.5	Q1	+ 2.0	Mar	+ 1.3	Mar	+15.7	Mar	+28.2	Q4	102.7	Mar
South Korea	+ 3.9	Q4	+11.6	Mar	+ 3.3	Apr	+25.1	Apr	+20.4	Mar	163.6	Mar
Taiwan	+ 5.2	Q4	+15.7	Mar	+ 0.9	Apr	+15.2	Apr	+28.6	Q4	227.7	Apr
Thailand	+ 7.8	Q4	+ 7.9	Mar	+ 2.5	Apr	+ 3.4	Mar	+ 7.6	Mar	41.9	Mar
Argentina	+11.3	Q4	+ 9.4	Apr	+ 3.1	Apr	+14.2	Mar	+ 7.9	Q4	15.8	Apr
Brazil	– 0.1	Q4	+11.9	Mar	+ 5.3	Apr	+27.4	Apr	+ 5.7	Mar	51.6	Mar
Chile	+ 3.3	Q4	+ 7.8	Mar	– 0.3	Apr	+ 5.0	Apr	– 0.6	Q4	16.0	Mar
Colombia	+ 4.3	Q4	+ 6.1	Feb	+ 5.5	Apr	+ 0.2	Feb	– 1.4	Q4	11.3	Mar
Mexico	+ 2.0	Q4	+ 6.4	Mar	+ 4.2	Mar	– 6.0	Mar	– 9.2	Q4	61.6	Mar
Peru	+ 5.5	Mar	+ 2.2	Feb	+ 2.8	Apr	+ 1.3	Mar	– 1.1	Q4	9.7	Mar
Venezuela	+29.8	Q1	+33.4	Feb	+23.1	Apr	+15.0	Q4	+ 9.6	Q4	17.2	Feb
Egypt	+ 3.1	2003†	+ 2.6	2003†	+ 5.5	Dec	– 6.0	Q4	+ 3.9	Q4	13.6	Feb
Israel	– 0.6	Q4	+ 8.8	Feb	– 1.5	Apr	– 5.4	Apr	– 0.2	Q4	27.0	Apr
South Africa	+ 1.5	Q4	+ 3.1	Mar	+ 0.4	Mar	+ 2.0	Mar	– 1.5	Q4	8.6	Apr
Turkey	+ 6.1	Q4	+14.9	Mar	+10.2	Apr	–23.7	Feb	– 8.1	Feb	32.9	Mar
Czech Republic	+ 3.1	Q4	+15.3	Mar	+ 2.3	Apr	– 2.4	Mar	– 5.7	Q4	26.1	Apr
Hungary	+ 3.6	Q4	+12.8	Mar	+ 6.9	Apr	– 3.9	Mar	– 6.5	Mar	10.0	Apr
Poland	+ 4.7	Q4	+23.8	Mar	+ 2.2	Apr	– 5.5	Mar	– 3.7	Feb	35.3	Mar
Russia	+ 8.0	Q1	+ 6.7	Apr	+10.3	Apr	+63.3	Mar	+35.3	Q1	78.9	Apr
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 5.7	Q4	+ 5.2	Mar	+ 1.3	Apr	– 2.0	Mar	– 1.2	Q1	1.3	Mar
Latvia	+ 7.4	Q4	+14.8	Mar	+ 5.0	Apr	– 2.2	Mar	– 1.1	Mar	1.4	Mar
Lithuania	+ 7.5	Q1	na		– 0.6	Apr	– 2.8	Mar	– 1.2	Q4	3.4	Mar
Slovakia	+ 4.7	Q4	+ 9.6	Mar	+ 8.0	Apr	– 0.5	Mar	nil	Feb	11.7	Mar
Slovenia	+ 2.5	Q4	+ 7.8	Mar	+ 3.5	Apr	– 0.8	Mar‡	nil	Mar	8.6	Feb
Pakistan	+ 5.1	2003†	+18.7	Jan	+ 6.0	Apr	– 1.9	Apr	+ 3.6	Q4†	11.5	Mar
Saudi Arabia	+ 6.4	2003	na		+ 0.4	Feb	+42.6	2002	+11.9	2002	21.6	Mar

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

May 20th 2004
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	May 19th		Dec 31st 2003	
	May 19th	year ago	May 19th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	14.8	4.00	1,634.3	– 2.8	+ 4.1	+ 4.1
Hong Kong	7.79	7.80	13.9	0.62	11,469.4	– 0.5	– 8.8	– 9.1
India	45.1	46.8	80.5	4.41	4,996.6	– 6.8	– 14.4	– 13.5
Indonesia	9,050	8,325	16,133	7.51	706.8	– 5.0	+ 2.2	– 4.9
Malaysia	3.80	3.80	6.77	2.99	793.8	– 3.0	nil	nil
Philippines	55.7	52.6	99.3	7.81	1,468.3	– 4.7	+ 1.8	+ 1.5
Singapore	1.71	1.73	3.06	0.81	1,765.3	– 2.0	nil	– 0.9
South Korea	1,174	1,194	2,092	3.90	778.0	– 4.8	– 4.0	– 2.6
Taiwan	33.4	34.6	59.5	1.10	5,860.6	– 1.6	– 0.5	+ 1.2
Thailand	40.7	42.0	72.6	1.29	615.0	– 1.1	– 20.4	– 22.5
Argentina	2.91	2.86	5.18	4.69	896.1	– 4.7	– 16.4	– 15.6
Brazil	3.09	3.01	5.51	15.76	18,717.8	+ 1.8	– 15.8	– 21.5
Chile	634	711	1,131	1.68	7,170.9	– 0.6	– 2.3	– 8.7
Colombia	2,736	2,914	4,877	7.87	2,991.9	+ 3.2	+ 28.2	+ 30.3
Mexico	11.5	10.2	20.6	6.55	9,767.6	+ 0.8	+ 11.1	+ 8.1
Peru	3.48	3.49	6.21	2.40	2,782.8	+ 4.1	+ 14.3	+ 13.7
Venezuela	3,086§	1,598	5,502	13.43	24,479.3	– 1.6	+ 10.2	+ 1.9
Egypt	6.19	5.96	11.03	10.50	14,393.9	– 4.2	+ 23.7	+ 23.2
Israel	4.59	4.58	8.18	1.00	562.0	+ 0.5	+ 5.2	+ 0.8
South Africa	6.72	7.70	12.0	8.20	10,090.8	+ 0.7	– 2.9	– 3.5
Turkey	1,543,498	1,503,000	2,751,593	24.79**	16,124.3	– 6.0	– 13.4	– 21.2
Czech Republic	26.5	26.9	47.2	2.15	762.3	– 0.1	+ 15.7	+ 12.1
Hungary	210	210	373	11.45	11,108.7	+ 5.2	+ 18.4	+ 17.3
Poland	3.90	3.74	6.96	5.89	23,261.2	+ 1.7	+ 11.7	+ 7.2
Russia	29.0	30.9	51.7	14.00	635.2‡	+ 7.7	+ 11.0	+ 12.0
EMF (MSCI)*	1.00	1.00	1.78	na	419.5	– 0.6	– 5.3	– 5.3
EMBI+†	1.00	1.00	1.78	na	279.6	+ 2.5	– 5.2	– 5.2

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate. **New series.

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